FILED

941688 APR 12 1995

OFFICE OF THE CLERK

No. _____

IN THE

Supreme Court of the United States

October Term, 1994

GEORGE MAITLAND, NEIL ROBBLEE and CARY GARMAN,
Petitioners,

v.

JOHN MITCHELL, JOHN MITCHELL, INC., an Oregon corporation, RODGERS HIGGINS, and HARRIS PINE MILLS, INC., an Oregon corporation,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

GREGORY A. HARTMAN
Counsel of Record

MICHAEL J. MORRIS
Bennett & Hartman
Suite 1600
851 S.W. Sixth Avenue
Portland, Oregon 97204
(503)227-4600

Counsel for Petitioners

April 12, 1995

eBCD Legal Printers, Seattle, Washington

101

QUESTIONS PRESENTED

Congress' bankruptcy reform legislation of 1978 and 1984 has led to uncertainty and conflict among the lower courts concerning the proper scope of the jurisdictional grants in 28 U.S.C. 157 and 28 U.S.C. 1334 over cases that may be "core" proceedings or otherwise "related to" bankruptcy. This case involves a significant Constitutional right threatened by the Ninth Circuit's decision below, and presents two questions:

I. Does Article III mandate that state common-law tort actions, of the type historically decided by juries and Article III judges, be considered "non-core" proceedings under 28 U.S.C. 157?

II. Does federal subject-matter jurisdiction under 28 U.S.C. 1334(b) over cases "related to" bankruptcy extend to state-law cases whose outcome could not have any binding effect on a bankruptcy estate?

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL PROVISION AND STATUTES INVOLVED	2
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE WRIT	6
POINT I	
The Ninth Circuit's decision to classify as "core" traditional state common-law tort cases that historically have been tried before juries and Art. III courts conflicts with *Marathon* and the better rule in other Circuits, and violates litigants' right to an Art. III forum	6
A. The Ninth Circuit's criterion for core vs. non-core status conflicts with the better-reasoned rule in other Circuits	6
B. The Ninth Circuit's definition of what is a "core proceeding" under 28 U.S.C. 157(b)(2) conflicts with Article III	12

Page

POINT II

The Ninth Circuit's assertion of bankruptcy-related federal subject-matter jurisdiction over cases having no possible binding effect on a bankruptcy estate conflicts with other Circuits that recognize substantive limits to such jurisdiction 17

POINT III

The threat this case presents to the continued vitality of Art. III, and the longstanding and widespread conflict over the proper reach of bankruptcy subject-matter jurisdiction, justify this Court's attention 25

CONCLUSION 27

APPENDIX

Decision of Court of Appeals dated January 12, 1995 . . . . . A-1

Decision of District Court, by the Hon. Helen J. Frye, U.S.D.J., dated November 14, 1990 . . . . . A-19

Decision of Bankruptcy Court, by the Hon. Elizabeth L. Perris, U.S.B.J., dated April 16, 1991 . . . . . A-23

Transcript of Oral Decision of Bankruptcy Court, by the Hon. Thomas T. Glover, dated May 7, 1992 . . . . . A-28

	Page
Decision of the District Court, by the Hon. Robert E. Jones, dated May 12, 1993	A-35
Petitioners' Complaint, dated August 1990 .	A-54
28 U.S.C. 157	A-61
28 U.S.C. 1334	A-63

TABLE OF AUTHORITIES

Cases	Page
Arnold Print Works, Inc. v. Apkin (In re Arnold Print Works, Inc.), 815 F.2d 165 (CA1 1987)	passim
Barnett v. Stern, 909 F.2d 973 (CA7 1990)	11
Berman v. Smith, 171 F. 735 (D.Ga. 1909)	15
Caterpillar Inc. v. Williams, 482 U.S. 386 (1987)	23
Dogpatch Properties, Inc. v. Dogpatch U.S.A., Inc. (In re Dogpatch U.S.A., Inc.), 810 F.2d 782 (CA8 1987)	8
Fietz v. Great Western Savings (In re Fietz), 852 F.2d 455 (CA9 1988)	9, 18, 19
Gardner v. U.S. (In re Gardner), 913 F.2d 1515 (CA10 1990)	11, 19
Gower v. Farmers Home Administration (In re Davis), 899 F.2d 1136 (CA11 1990), cert. denied, 498 U.S. 981 (1990)	11
Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989)	7
Great Northern Ry. Co. v. Alexander, 246 U.S. 276 (1918)	23

Cases - continued	Page
Hall v. Perry (In re Cochise College Park, Inc.), 703 F.2d 1339 (CA9 1983).....	23
Hays and Co. v. Merrill Lynch, 885 F.2d 1149 (CA3 1989).....	11
Home Insurance Co. v. Cooper & Cooper, Ltd., 889 F.2d 746 (CA7 1989).....	20
Howell Hydrocarbons, Inc. v. Adams, 897 F.2d 183 (CA5 1990).....	6
In re Chicago, Rock Island and Pacific Railroad Co., 794 F.2d 1182 (CA7 1986).....	20
Katchen v. Landy, 382 U.S. 323 (1966).....	15
Kelley v. Nodine (In re Salem Mortgage Co.), 783 F.2d 626 (CA6 1986).....	21
Langenkamp v. Culp, 498 U.S. 42 (1990).....	15
Libhart v. Santa Monica Dairy Co., 592 F.2d 1062 (CA9 1979).....	23
Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.), 910 F.2d 784 (CA11 1990).....	19
Mollan v. Torrance, 22 U.S. (9 Wheat.) 536 (1824).....	23
Morales v. Trans World Airlines, Inc., 504 U.S. 976 (1992).....	24

Cases - continued	Page
National City Bank v. Coopers and Lybrand, 802 F.2d 990 (CA8 1986).....	22
Northern Pipeline Construction Co., v. Marathon Pipe Line Co., 458 U.S. 50 (1982)..	passim
Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095 (CA2 1993).....	9
Pacor, Inc. v. Higgins, 743 F.2d 984 (CA3 1984).....	21, 22, 23
Perkins v. Time Insurance Co., 898 F.2d 470 (CA5 1990).....	25
Piombo Corp. v. Castlerock Properties (In re Castlerock Properties), 781 F.2d 159 (CA9 1986).....	23
Quattrone Accountants, Inc. v. I.R.S., 895 F.2d 921 (CA3 1990).....	21, 22
Shaw v. Delta Air Lines, Inc., 463 U.S. 85 (1983).....	24
Turner v. Ermiger (In re Turner), 724 F.2d 338 (CA2 1983).....	19
Wisconsin Dept. of Industry, Labor and Human Relations v. Marine Bank Monroe (In re Kubly), 818 F.2d 643 (CA7 1987).....	20

Cases - continued	Page
Wood v. Wood (In re Wood), 825 F.2d 90 (CA5 1987).....	passim
Statutes	
28 U.S.C. 157.....	passim
28 U.S.C. 158.....	12
28 U.S.C. 1254(1).....	2
28 U.S.C. 1334.....	passim
28 U.S.C. 1408.....	26
28 U.S.C. 1409.....	26
28 U.S.C. 1452.....	26
29 U.S.C. 1144(a).....	24
49 U.S.C. App. 1305(a)(1).....	24
Miscellaneous	
1 *Collier on Bankruptcy* (15th rev. ed. 1994)..	26
2 *Collier on Bankruptcy* (14th rev. ed. 1976)..	15
1 *Oregon Civil Pleading and Practice* (Or. State Bar, 4th ed. 1994).....	23

IN THE SUPREME COURT
OF THE UNITED STATES

October Term, 1994

GEORGE MAITLAND, NEIL ROBBLEE
and CARY GARMAN,
Petitioners,

v.

JOHN MITCHELL,
JOHN MITCHELL, INC., an Oregon
corporation, RODGERS HIGGINS, and
HARRIS PINE MILLS, INC., an Oregon
corporation,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

George Maitland, Neil Robblee and Cary Garman respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals for the Ninth Circuit is reported at 44 F.3d 1431 (CA9 1995). It appears in the Appendix at A-1.

The opinion and order of the Honorable Helen J. Frye of the United States District Court for the District of Oregon, determining that this case is core and referring it to the Bankruptcy Court, have not been reported. They appear in the Appendix at A-19.

The decision of the Honorable Elizabeth L. Perris of the United States Bankruptcy Court for the District of Oregon, denying defendants' motion for summary judgment, has not been reported. It appears in the Appendix at A-23.

The oral decision of the United States Bankruptcy Court for the District of Oregon, by the Honorable Thomas T. Glover, visiting Bankruptcy Judge, granting plaintiffs' and defendants' summary judgment motions on the merits, has not been reported. The pages of the transcript of the hearing in which the decision appears are reprined in the Appendix at A-28.

The opinion and order of the Honorable Robert E. Jones of the United States District Court for the District of Oregon on appeal from the Bankruptcy Court decision granting summary judgment, has not been reported. It appears in the Appendix at A-35.

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on January 12, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

The Constitutional provision involved in this petition for certiorari is Article III.

The statutes involved in this petition for certiorari are 28 U.S.C. 157 and 28 U.S.C. 1334, which are reprinted in the Appendix at A-61 and A-63, respectively.

STATEMENT OF THE CASE

In 1988 petitioners George Maitland, Neil Robblee and Cary Garman (collectively, the "Investors") learned that the furniture division of Harris Pine Mills ("HPM") may be for sale. The Investors were interested in funding a new corporation to acquire a furniture business, and communicated their interest to John Mitchell ("Mitchell"), HPM's manager and the President of John Mitchell, Inc. ("JMI"), the bankruptcy trustee of the estate of HPM. HPM at the time was reorganizing under Chapter 11 of the Bankruptcy Code, and JMI was selling off the operating divisions and other assets of HPM.

Over a period of several months Mitchell and another JMI employee, Rodgers Higgins ("Higgins"), both certified public accountants, provided to the Investors HPM financial statements they had prepared, and made other representations concerning the operations of the furniture division.

After receiving the financial statements and representations, the Investors and another party formed and capitalized a new corporation, Harris of Pendleton, Inc. ("HOPI"). HOPI purchased the HPM furniture division in January, 1989. Shortly thereafter, HOPI encountered financial difficulty, filed for protection under the Bankruptcy Code, and was liquidated. The Investors lost their entire investment in HOPI.

In August, 1990 the Investors filed an action for damages in state court, asserting state common-law tort claims against Mitchell, Higgins and JMI (collectively, "Mitchell & Higgins")

in their individual capacities. The Investors alleged, *inter alia*, that Mitchell & Higgins had fraudulently induced the Investors to invest in HOPI by providing false financial statements and making other fraudulent misrepresentations to the Investors. No claims were asserted against the estate of HPM. The Investors demanded a jury trial. The complaint is reprinted in the Appendix at A-54.

At the time the lawsuit was filed the HPM plan of reorganization had been approved and all allowed claims had been paid in full, except for those of HPM's sole shareholder. JMI had been awarded a trustee's fee of $1.25 million.

Mitchell & Higgins removed the case to the United States District Court for the District of Oregon. The Investors moved to remand the case to state court, asserting that the district court lacked subject matter jurisdiction under 28 U.S.C. 1334(b) in that the Investors' claims were not "related to" a case under title 11, and alternatively that the case was a "non-core" proceeding subject to mandatory abstention under 28 U.S.C. 1334(c)(2). Mitchell & Higgins moved to have the case referred to the bankruptcy court. While recognizing that the Investor's claims were against them in their individual capacities, Mitchell & Higgins argued that the case was nevertheless "core" because issues in the case were tied to the HPM bankruptcy, and Mitchell & Higgins might seek indemnity from the HPM estate, and thus the Investors' claims affected the administration or the liquidation of the estate. There was no diversity jurisdiction.

The Honorable Helen J. Frye, U.S.D.J., in an opinion and order dated November 14, 1990, held that the case was a core proceeding under the provisions of 28 U.S.C. 157(b)(2)(A) and (O). Judge Frye referred the case to the United States Bankruptcy Court for the District of Oregon. App. A-22.

After referral to the bankruptcy court the Investors amended their complaint, adding a state RICO claim and asserting claims against the estate of HPM in addition to those already asserted against Mitchell & Higgins in their individual capacities.

In the Bankruptcy Court the Honorable Elizabeth L. Perris, U.S.B.J. on April 16, 1991 denied Mitchell & Higgins' motion for summary judgment, holding that applicable state law granted a corporate shareholder a cause of action, separate from the corporation, for fraudulent inducement. App. A-23. On May 7, 1992 the Honorable Thomas T. Glover, visiting U.S.B.J., orally granted summary judgment on the merits to all parties as to all claims. App. A-28. Judge Glover did not hear argument or rule on any of the jurisdictional issues in the case. The parties appealed Judge Glover's decision to the United States District Court for the District of Oregon. In a March 12, 1993 written opinion and order the Honorable Robert E. Jones, U.S.D.J., affirmed Judge Perris' and Judge Glover's summary judgment decisions, and stated that Judge Frye's order of referral was correct. App. A-35.

The parties appealed Judge Jones' decision to the Court of Appeals for the Ninth Circuit. In a January 12, 1995 opinion reported in 44 F.3d 1431 and reprinted in the Appendix at A-1, the Court of Appeals affirmed the summary judgment dismissal of the Investors' claims, reversed the summary judgment dismissal of the claims of Mitchell & Higgins, and remanded. In the opinion the Court of Appeals concluded that the action was a core proceeding because the trustee's conduct was "inextricably entwined with the trustee's sale of property belonging to the bankruptcy estate." App. A-13.

REASONS FOR GRANTING THE WRIT

POINT I

THE NINTH CIRCUIT'S DECISION TO CLASSIFY AS "CORE" TRADITIONAL STATE COMMON-LAW TORT CASES THAT HISTORICALLY HAVE BEEN TRIED BEFORE JURIES AND ART. III COURTS CONFLICTS WITH *MARATHON* AND THE BETTER RULE IN OTHER CIRCUITS, AND VIOLATES LITIGANTS' RIGHT TO AN ART. III FORUM

A. THE NINTH CIRCUIT'S CRITERION FOR CORE VS. NON-CORE STATUS CONFLICTS WITH THE BETTER-REASONED RULE IN OTHER CIRCUITS.

The Ninth Circuit's decision that the Investors' state common-law tort action was a "core proceeding" under 28 USC 157(b)(2) conflicts squarely with the Fifth Circuit, as well as with the Third, Seventh, Tenth and Eleventh Circuits, which have adopted the Fifth Circuit's approach.

This conflict among the Circuits over the proper distinction between core and non-core proceedings creates uncertainty at the foundation of bankruptcy jurisdiction. The core/non-core distinction most commony is made to determine whether a case is to be tried in the bankruptcy court (if it is a core case) or in the District Court (if it is a non-core case.) *See, e.g., Wood v. Wood (In re Wood)*, 825 F.2d 90 (CA5 1987). The distinction may also determine whether a previous bankruptcy court decision is *res judicata* as to a later claim not brought in the previous bankruptcy court proceeding. *See, e.g., Howell Hydrocarbons, Inc. v. Adams*, 897 F.2d 183 (CA5 1990). In cases such as the one at bar, the designation

also determines whether the mandatory abstention provisions of 28 USC § 1334(c)(2) might apply.[1]

The core/non-core distinction may also have a bearing on whether the litigants are entitled to a jury trial under the Seventh Amendment of the Constitution:

> [I]f the action must be tried under the auspices of an Article III court, then the Seventh Amendment affords the parties a right to a jury trial whenever the cause of action is legal in nature.

Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 53 (1989). So to the extent that a "non-core" designation of a case is mandated by Article III, then the Seventh Amendment would also mandate that the parties are entitled to a jury trial if the case is legal and not equitable in nature.

The core/non-core distinction thus has an overriding importance in the resolution of many disparate jurisdictional and substantive issues.

The Circuit Courts have had the greatest difficulty distinguishing a "core proceeding" from a non-core proceeding that is only "related to" the bankrutpcy when the matter at hand does not fit within any of the "enumerated" core categories in 28 U.S.C. 157(b)(2), subsections (B) through (N) (e.g., allowance of claims, motions to terminate the automatic stay, etc.). Then the courts must look instead to the "catch-all" core categories of subsection 157(b)(2)(A) ("matters concerning the administration of the estate") and subsection 157(b)(2)(O) ("proceedings affecting the liquidation of the assets of the state or the adjustment of the debtor-creditor . . . relationship").

---

[1] By characterizing the Investors' action as a "core" proceeding the District Court below denied, *sub silentio*, the Investors' motion for mandatory abstention.

In two Circuits, the Eighth and the Ninth, the criterion for core status under these catch-all categories is the nexus or relationship between the case and the estate, a criterion that, as will be seen, is open-ended and indefinite in application.

The Eighth Circuit in *Dogpatch Properties, Inc. v. Dogpatch U.S.A., Inc. (In re Dogpatch U.S.A., Inc.)*, 810 F.2d 782 (CA8 1987) found core jurisdiction to exist over a dispute between non-debtors over obligations arising out of the post-petition sale of real estate constituting the debtor's principal asset. As a condition of the sale the purchasers had guaranteed the underlying mortgage on the property. Even though the dispute was not an enumerated core proceeding, the court found it to be core, as well as "related," because the property was the principal asset of the estate, and the debtor's reorganization would fail unless the sales contract and guaranties were enforced.

The Eighth Circuit thus adopted a criticality standard: if the case is critical enough to the bankruptcy, it is core. *See id.* at 785-86.

The Ninth Circuit in the case at bar also had difficulty finding any specific basis for asserting core jurisdiction. Ultimately it found the Investors' case to be core because Mitchell & Higgins' alleged misrepresentation was "inextricably entwined with the trustee's sale of property belonging to the estate." App. A-13. The Ninth Circuit's opinion did not specify which core category it considered applicable, but cited subsections (A) and (O) in the course of the opinion. One can surmise that the court believed the case fit into one or both of these catch-all core categories.

The Second Circuit has put its finger on the problem with the type of reasoning used by the Eighth and Ninth Circuits.

The court in *Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095 (CA2 1993), criticized a lower court's reasoning that a debtor's collection action on a large pre-petition contract was a core proceeding because prompt collection was "essential to the administration of the estate and the adjustment of the debtor-creditor relationships since these funds are *inextricably linked* to the liquidation of the estate." *Id.* at 1102 (emphasis supplied). The Second Circuit, citing *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), responded to such reasoning:

> [T]his approach . . . *creates an exception to Marathon that would swallow the rule.* Any contract action that the debtor would pursue against a defendant presumably would be expected to inure to the beneift of the debtor estate and thus "concern[s]" its "administration."

Id. (emphasis supplied)

So too the approach of the Eight and Ninth Circuits could swallow *Marathon* whole. Anyone asserting a traditional common-law claim could lose his or her right to Article III adjudication if the claim's possible effect on the administration or liquidation of the estate were perceived to be critical or "inextricable."

The Ninth Circuit's test in particular, "inextricably entwined," is so broad that it bears a remarkable resemblence to its expansive test for "related to" jurisdiction: whether a case "could conceivably have any effect" on the estate. *Fietz v. Great Western Savings (In re Fietz)*, 852 F.2d 455, 457 (CA9 1988) (See discussion of the *In re Fietz* standard below in Point II). The Ninth Circuit's reasoning threatens to subsume entirely the Article III jurisdiction of the District Court over

bankruptcy-related matters and place nearly every such case in the bankruptcy court, for there is little definable distance between a matter that might affect the estate, and one that is "entwined" with the estate.

The Fifth Circuit, employing an entirely different rationale than those of the Eighth and Ninth Circuits, reached the opposite result on facts similar to those in the case at bar. In *Wood v. Wood (In re Wood)*, 825 F.2d 90 (CA5 1987) a non-debtor sued the debtor and another party for post-petition misappropriation of corporate assets. Rather than basing its core/non-core decision on whether the case was "entwined" with the administration of the estate, the Fifth Circuit asked whether the case was one "arising under" Title 11, or "arising in" a Title 11 case, as defined in subsection 157(b)(1). The *Wood* court equated "core" with "arising under" and "arising in" as those terms are used in subsection 157(b)(1), noting that Section 157 "incorporates the principles suggested in the language of the *Marathon* opinions." *Id.* at 91. The court properly categorized the case as non-core because it neither arose under title 11 nor arose in a case under title 11:

> If the proceeding does not invoke a substantive right created by the federal bankruptcy law and is one that could exist outside of bankruptcy it is not a core proceeding; it may be *related to* the bankruptcy because of its potential effect, but under section 157(c)(1) it is an "otherwise related" or non-core proceeding.

Id. at 97 (emphasis in original). Applying this standard, the court found that the plaintiff's claim involved only state substantive rights, and could have proceeded in state court had there been no bankruptcy. But the case's possibly important *effect* on the bankruptcy could not, under the rationale in *Wood*, turn the case into a core proceeding.

The Seventh Circuit approved of this *Wood* standard because

> We believe that the approach of *Wood* and its progeny reflects most precisely the constitutional policy concerns expressed by the Supreme Court in *Marathon* and by Congress in the Bankruptcy Amendments and Federal Judgeship Act of 1984.

Barnett v. Stern, 909 F.2d 973, 981 (CA7 1990). The *Wood* approach has also been adopted by a number of other Circuits, including the the Third Circuit in *Hays and Co. v. Merrill Lynch*, 885 F.2d 1149, 1156 n. 9 (CA3 1989), the Tenth Circuit in *Gardner v. U.S. (In re Gardner)*, 913 F.2d 1515, 1518 (CA10 1990), and the Eleventh Circuit in *Gower v. Farmers Home Administration (In re Davis)*, 899 F.2d 1136, 1140-41 (CA11 1990), *cert. denied*, 498 U.S. 981 (1990).

The conflict between the Eighth and Ninth Circuits on the one hand and those Circuits adopting the *Wood* analysis on the other hand, is over whether to incorporate this Court's *Marathon* opinions into the core/non-core definition. The *Wood* court based its construction of Section 157's core/non-core distinction on whether the litigants were entitled to adjudication by an Article III court. The Ninth Circuit, on the other hand, read the core enumerations in subsection 157(b)(2) in isolation, without considering whether or not, under subsection 157(b)(1), the case "arises under" the bankruptcy laws or "arises in" a bankruptcy case.

Only by ignoring the jurisdictional principles embedded in subsection 157(b)(1) was the Ninth Circuit able to construe "matters concerning the administration of the estate" so broadly as to include "'traditional' state common-law actions" (*Marathon*, 458 U.S. at 92 (dissent of Burger, C.J.)) such as the instant case, actions which should, according to *Marathon*, be heard by an Article III judge.

B. THE NINTH CIRCUIT'S DEFINITION OF WHAT IS A "CORE PROCEEDING" UNDER 28 U.S.C. 157(b)(2) CONFLICTS WITH ARTICLE III.

A case determined to be a "core proceeding" under 28 U.S.C. 157(b)(2) may be referred to and tried by an Article I bankruptcy court with only traditional appellate review by an Article III court. 28 U.S.C. 157(b)(1); 28 U.S.C. 158. On the other hand, a "non-core" or "related to" proceeding must be decided, at the option of either party, by a District Court. 28 U.S.C. 157(c)(1).

But if a case classified as core and referred to the bankruptcy court for decision is one that Article III of the U.S. Constitution preserves for adjudication by an Article III court, that core classification then becomes subject to the same constitutional infirmity found in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

The Ninth Circuit below classified as core the Investors' tortious misrepresentation claims against a trustee and its agents in their individual capacities. Those claims are very similar in nature to the claims asserted in *Marathon*. By applying *Marathon*'s definitions of what type of case must be adjudicated by an Article III court, it becomes clear that the Ninth Circuit adopted a definition that would classify as core many claims that cannot constitutionally be decided by an Article I court.

From the *Marathon* opinions two complementary approaches emerge for evaluating whether a case must be decided by an Article III court. The first approach is the concept of "public," as opposed to "private," rights, articulated in the plurality opinion of Justice Brennan:

> [A] matter of public rights must at a minimum arise "between the government and others." [citations omitted] In contrast, "the liability of one individual to another under the law as defined," [citation omitted] is a matter of private rights. Our precedents clearly establish that only controversies in the former category may be removed from Art. III courts . . . . [citations omitted] Private-rights disputes, on the other hand, lie at the core of the historically recognized judicial power.

Id. at 69-70. The plurality found the contract and misrepresentation claims in the case to involve "the adjudication of state-created private rights," and not "the restructuring of debtor-creditor relations" that would involve public rights. *Id.* at 71.

The concurring opinion of Chief Justice (then Justice) Rehnquist represents the second approach. He noted that the plaintiff's action in the case

> seeks damages for breach of contract, misrepresentation, and the other counts which are the stuff of traditional actions at common law tried by the courts at Westminster in 1789. There is apparently no federal rule of decision provided for any of the issues in the lawsuit; the claims of Northern arise entirely under state law.

Id. at 90. Justice Rehnquist agreed with the plurality that allowing the bankruptcy court to decide a lawsuit of this nature would "be violative of Art. III of the United States Constitution." *Id.* at 91.

While the two approaches may differ in some respects, they are in agreement regarding the type of traditional state common-law action between individuals that is involved in the

instant case. Both agree that such an action alleging misrepresentation is one that must be heard by an Article III forum.

A few years after the *Marathon* decision, Justice (then Judge) Breyer summarized several Supreme Court cases dealing with Art. III, including *Marathon*, in *Arnold Print Works, Inc. v. Apkin (In re Arnold Print Works, Inc.)*, 815 F.2d 165, 169 (CA1 1987):

> The Supreme Court has repeatedly turned to history and tradition to help define the type of adjudicatory proceeding that the Constitution reserves exclusively for Article III courts. . . . The Court has indicated that it will examine closely congressional attempts to control the adjudication of "rights [that] were *historically* . . . subject to resolution by Article III courts."

(quoting from *C.F.T.C. v. Schor*, 478 U.S. 833, 854 (1986)) (emphasis supplied by Judge Breyer).

Holding the claims before him up to this measure, Judge Breyer found that they were not

> matters that "historically" have been decided only in the equivalent of Article III courts. To the contrary, bankruptcy courts have adjudicated claims like this one at least since the enactment of the Bankruptcy Act of 1898.

Id.

Holding the Investors' claims in the case at bar up to the same measure, it is just as clear that claims of this nature historically *have* been tried by Article III courts and juries, and *have not* been historically been adjudicated by bankruptcy courts. Under pre-1978 law it was "crystal clear," to borrow a

phrase from *Arnold Print Works, Inc.*, 815 F.2d at 169, that tort actions against trustees need not be tried in bankruptcy courts:

> Where a receiver exceeds his authority, he may be sued personally in a state court without leave of the bankruptcy court. Likewise, *he may be sued in state court without such leave for torts committed in the conduct of the bankrupt's business.* . . . The same rules apply to the trustee in bankruptcy.

2 *Collier on Bankruptcy* ¶ 23.20 (14th rev. ed. 1976) (emphasis supplied). Indeed, this has been the clear rule at least since the enactment of the Bankruptcy Act of 1898:

> There is no question that suit may be brought in the state courts for wrongful acts of officers of the bankruptcy court, where they go entirely beyond their duties as such officer and are guilty of conduct which is actionable in its character, particularly as against third persons.

Berman v. Smith, 171 F. 735, 743 (D.Ga. 1909).

Nor is there in the instant case any element of the implied consent that supported bankruptcy jurisdiction in *Arnold Print Works*. The court in *Arnold Print Works* categorized as core the enforcement of a post-petition contract with a debtor-in-possession, applying the traditional doctrine that a party contracting with a bankruptcy trustee "subjects himself for purposes of the contract" to the bankruptcy court's jurisdiction. *Arnold Print Works, supra*, at 170 (quoting from *In re California Eastern Airways*, 95 F.Supp. 348, 351 (D.Del. 1951)).

But the doctrine of implied consent to bankruptcy jurisdiction (reflected also in *Katchen v. Landy*, 382 U.S. 323

(1966) and in *Langenkamp v. Culp,* 498 U.S. 42 (1990)), has no application where there is no contract or creditor's claim from which consent may be implied. The typical tort claim, such as in the case at bar, arises from alleged misconduct occurring before the plaintiff has had any other dealings or relationship with the defendant.

From the above discussion it is clear that the Investors' claims in the instant case are "the stuff of traditional actions at common law," *Marathon*, 458 U.S. at 90, claims that have historically been tried in Article III courts. Claims of this kind should be protected from nonconsensual referral to bankruptcy court.

In order to resolve the constitutional problem created by the Ninth Circuit, it should not be necessary to invalidate any congressional enactment, as the Court in *Marathon* had to do. Rather, it is possible, and well within the bounds of common sense and plain meaning, to construe 28 U.S.C. 157(b)(2), and specifically the catch-all provisions of subsections (A) and (O), so that they do not run afoul of Article III.

Lower courts analyzing the legislative history of Section 157 agree that Congress did not intend to violate Article III at all when it adopted the "core proceeding" approach. Rather, the primary purpose of Section 157 was to come back into compliance with Article III in response to *Marathon*: "Section 157 of the 1984 Act incorporates the principles suggested in the Marathon opinions." *Wood v. Wood (In re Wood),* 825 F.2d 90, 96 (CA5 1987). *See also, Arnold Print Works,* 815 F.2d at 168 ("Congress intended that 'core proceedings' would be interpreted broadly, close to or congruent with constitutional limits.")

But the Ninth Circuit below made no attempt to make Section 157(b)(2) congruent with constitutional limits. It

stretched the catch-all definitions in subsections (A) and (O) beyond any reasonable meaning, and thereby intruded into a constitutionally protected area.

POINT II

THE NINTH CIRCUIT'S ASSERTION OF BANKRUPTCY-RELATED FEDERAL SUBJECT-MATTER JURISDICTION OVER CASES HAVING NO POSSIBLE BINDING EFFECT ON A BANKRUPTCY ESTATE CONFLICTS WITH OTHER CIRCUITS THAT RECOGNIZE SUBSTANTIVE LIMITS TO SUCH JURISDICTION.

The Circuit Courts have for some time had divergent and conflicting opinions of how far federal subject matter jurisdiction extends over proceedings "related to" bankruptcy cases, pursuant to 28 U.S.C. 1334(b). This Court has only once briefly construed the "related to" jurisdictional grant, in *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). The plurality in *Marathon* commented on the "related to" clause (then codified as 28 U.S.C. 1471(b)):

> The jurisdiction of the bankruptcy courts created by the Act [i.e., the Bankruptcy Act of 1978] is much broader than that exercised under the former referee system. Eliminating the distinction between "summary" and "plenary" jurisdiction, the Act grants the new courts jurisdiction over all "civil proceedings arising under title 11 (the Bankruptcy title) or arising in or *related to* cases under title 11" 28 U.S.C. § 1471(b). . . . This jurisdictional grant empowers bankruptcy courts to entertain a wide variety of cases involving claims that may affect the property of the estate once a petition has been filed under Title 11.

Id. at 54 (emphasis in original).

In a dissent, Chief Justice Burger may also have been referring to the "related to" jurisdictional grant in characterizing the majority's holding:

> [T]he Court's holding is limited to the proposition stated by Justice Rehnquist in his concurrence in the judgment -- that a "traditional" state common-law action, not made subject to a federal rule of decision, and related only peripherally to an adjudication of bankruptcy under federal law, must, absent the consent of the litigants, be heard by an "Art. III court"
> . . . .

Id. at 92.

From *Marathon*'s brief description of matters that "may affect the property of the estate," and those at least "peripherally related to the adjudication of bankruptcy," the Courts of Appeal have developed conflicting definitions of the scope of the "related to" jurisdiction of Section 1334(b).

The conflict between the Circuits is as well-recognized as it is of long standing. The Ninth Circuit in *Fietz v. Great Western Savings (In re Fietz)*, 852 F.2d 455, 457 (CA9 1988), catalogued the cases on both sides of the conflict, and the Eleventh Circuit in *Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.)*, 910 F.2d 784, 788 (CA11 1990) described the conflict:

> [T]he Fourth, Fifth and Ninth Circuits have adopted the *Pacor* test without modification. [citations omitted] The Second, Sixth and Seventh Circuits have adopted a more restrictive form of the *Pacor* test. Their formulations may deny jurisdiction in cases where the dispute's probable effect on the debtor's estate, while conceivable, is nonetheless remote.

The Court of Appeal with the most expansive definition, the Ninth Circuit, considers a proceeding to be "related to" a bankruptcy case if "*the outcome of the proceeding could conceivably have any effect on the estate being administered in bankruptcy.*" *Fietz v. Great Western Savings (In re Fietz)*, 852 F.2d 455, 457 (CA9 1988) (quoting from *Pacor, Inc. v. Higgins*, 743 F.2d 984, 995 (CA3 1984) (emphasis in original). Underscoring the breadth of its position, the *Fietz* court added: "We reject any limitation on this definition." *Id.*[2]

Other circuits adopting the formulation that any proceeding is "related to" a bankruptcy case if its outcome could "conceivably have any effect" on the bankruptcy estate include the Fifth Circuit in *Wood v. Wood (In re Wood)*, 825 F.2d 90, 93 (CA5 1987); the Tenth Circuit in *Gardner v. U.S. (In re Gardner)*, 913 F.2d 1515, 1518 (CA10 1990); and the Eleventh Circuit in *Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.)*, 910 F.2d 784, 788 (CA11 1990).

In contrast, other Circuit Courts have articulated tests of "related to" bankruptcy jurisdiction which include some limit to their reach where the relationship or nexus to the bankruptcy estate is too remote or tenuous.

The Second Circuit, for instance, requires a showing of a "significant connection" with a bankruptcy case. *Turner v. Ermiger (In re Turner)*, 724 F.2d 338, 341 (CA2 1983). The "significant connection" approach is well supported by legislative history; the *Turner* court adopted its "significant connection" test verbatim from a portion of the report of the

---

[2] Although the Investors in the case at bar argued that federal jurisdiction was lacking under Section 1334(b), the courts below asserted jurisdiction in the case solely by holding that the case was "core" under Section 157(b)(2), and made no explicit alternative holding that the case was also "related" to the bankruptcy.

Commission on Bankruptcy Laws of the United States, which was quoted in the House Report accompanying tne original adoption of the precursor to Section 1334.

The Seventh Circuit has also interpreted the "related to" jurisdictional language "narrowly," rejecting jurisdiction if the dispute "does not necessarily have a financial effect on the estate (or the apportionment among its creditors)," *Home Insurance Co. v. Cooper & Cooper, Ltd.*, 889 F.2d 746, 749 (CA7 1989). Justifying its more restrictive interpretation, the court stated,

> We have read § 157(c) narrowly not only out of respect for Article III but also to preserve the jurisdiction of state courts over questions of state law involving persons not party to the bankruptcy.

Id.

Another Seventh Circuit decision applying that Circuit's narrower standard explicitly rejected the position that bankruptcy jurisdiction existed whenever there was a "logical relationship or nexus between a proceeding and a bankruptcy case," stating,

> courts must be particularly careful in ascertaining the source of their power, lest bankruptcy courts displace state courts for large categories of disputes in which some party . . . may be bankrupt.

Wisconsin Dept. of Industry, Labor and Human Relations v. Marine Bank Monroe (In re Kubly), 818 F.2d 643, 645 (CA7 1987) See also *In re Chicago, Rock Island and Pacific Railroad Co.*, 794 F.2d 1182, 1187-88 (CA7 1986) (rejecting "related to" jurisdiction sought on the strength of the "indirect, underlying relationship of the Trustee" to the case).

The Sixth Circuit has also adopted a somewhat restrictive test, allowing that "situations may arise where an extremely tenuous connection to the estate would not satisfy the jurisdictional requirement . . . ." *Kelley v. Nodine (In re Salem Mortgage Co.)*, 783 F.2d 626, 634 (CA6 1986).

The Third Circuit also applies a much more restrictive jurisdictional standard. Although it was apparently the first Circuit Court to enunciate the "any conceivable affect on the estate" formula, the Third Circuit actually interprets and applies the standard quite differently than do the other Circuits, recognizing jurisdiction only if the proceeding *must necessarily* have some effect on the estate. In *Pacor, Inc. v. Higgins*, 743 F.2d 984 (CA3 1984), for instance, the Third Circuit held that a product liability action against a product's distributor, Pacor, for injuries allegedly caused by products manufactured by bankrupt Manville, was not "related to" the manufacturer's bankruptcy case:

> [T]he primary action between Higgins and Pacor would have no effect on the Manville bankruptcy estate, and therefore is not "related to" bankruptcy within the meaning of section 1471(b). At best, it is a mere precursor to the potential third party claim for indemnification by Pacor against Manville. Yet the outcome of the Higgins-Pacor action would in no way bind Manville, in that it could not determine any rights, liabilities, or course of action of the debtor.

Id. at 995.

The Third Circuit again rejected the potential contingent liability of a bankruptcy estate as a basis for jurisdiction in *Quattrone Accountants, Inc. v. I.R.S.*, 895 F.2d 921 (CA3 1990), where the court held that the outcome of the I.R.S.'s collection action against a corporate officer for the debtor corporation's withholding tax liability under 26 U.S.C. 6672

would not "conceivably have any effect on the bankrupt estate," *id.* at 927 n. 4, in spite of the fact that any payments by the officer in satisfaction of a judgment in the collection action would enhance the value of the debtor's estate by reducing the debtor corporation's own liability to the I.R.S.

Following *Pacor*'s holding in another case factually analogous to the instant case, the Eighth Circuit in *National City Bank v. Coopers and Lybrand*, 802 F.2d 990 (CA8 1986), determined there was no "related to" federal subject matter jurisdiction under Section 1334(b) to adjudicate an action by a third party lender alleging, *inter alia*, accounting fraud and negligence against the debtor's accountants, even though the accountants potentially could have sought indemnity against the debtor.

In summary, courts applying a more restrictive "related to" jurisdictional test have held that no federal jurisdiction exists under Section 1334(b) to adjudicate proceedings, such as the case at bar, which may only potentially give rise to indemnification claims against the bankrutpcy estate. Those courts applying the more expansive test, on the other hand, have reached the opposite outcome. For example, in *Wood v. Wood (In re Wood)*, 825 F.2d 90 (CA5 1987), one of the cases adopting the expansive "any conceivable effect" formula, the debtor and a non-debtor were jointly sued for misappropriation of corporate assets. The Fifth Circuit held that the claim against the non-debtor was "related to" the debtor's bankruptcy because recovery against the non-debtor could potentially reduce the debtor's own joint liability. *Wood* thus reached a conclusion opposite to the that reached by the more restrictive Third Circuit in *Quattrone Accountants, Inc., supra*, in a similar factual setting.

Any potential indemnity claim against the HPM estate by Mitchell & Higgins in the case at bar is as contingent as the

indemnity claims in *Pacor* and the other cases discussed above. The Investors made no claims against the estate in their original state court action.[3] Under the established doctrine of the Ninth Circuit a bankruptcy trustee is "subject to personal liability for not only intentional but also negligent violations of duties imposed on him by law." *Hall v. Perry (In re Cochise College Park, Inc.)*, 703 F.2d 1339, 1357 (CA9 1983). Inasmuch as the Investors alleged only fraud and negligence claims against Mitchell & Higgins personally, any judgment would be recoverable only against them individually, and they would not then have an indemnity claim against the HPM estate.

The essence of the conflict among the Circuits is the question whether any degree of remoteness, tenuousness or contingency in the relationship between a state-law proceeding and a bankruptcy estate could vitiate federal subject-matter jurisdiction over the state-law proceeding. Must the relationship or connection be at least to some degree substantial to

---

[3] In fact, under applicable local law the Investors *had* to sue Mitchell & Higgins in their individual capacities: "When a trustee commits a tort, he or she is personally liable and must be sued in an individual capacity." 1 *Oregon Civil Pleading and Practice* § 6.15 (Or. State Bar, 4th ed. 1994).

After their case was removed and referred to the bankruptcy court Mitchell & Higgins asserted defenses and counterclaims, and the Investors added claims against the HPM estate. But such subsequent events do not affect the federal jurisdiction over the case. Federal jurisdiction is governed by the state of things at the time the action is filed, *Mollan v. Torrance*, 22 U.S. (9 Wheat.) 536, 539 (1824), and by the allegations in the complaint, *Caterpillar Inc. v. Williams*, 482 U.S. 386, 392 (1987), but not by the defendant's pleadings. *Great Northern Ry. Co. v. Alexander*, 246 U.S. 276 (1918). Likewise, the Investors' additional claims asserted after removal do not confer removal jurisdiction where none originally existed. *Libhart v. Santa Monica Dairy Co.*, 592 F.2d 1062 (CA9 1979). And the Investors did not waive their objections to bankruptcy jurisdiction by making claims against the HPM estate after being referred over their objections. *Piombo Corp. v. Castlerock Properties (In re Castlerock Properties)*, 781 F.2d 159 (CA9 1986).

create jurisdiction, or can any nexus or connection to a bankruptcy case, no matter how remote or tenuous, provide enough of a relationship to create federal jurisdiction over the state-law action? This important question is in need of a definitive answer.

In similar contexts this Court has placed limits on the reach of statutes similar to Section 1334(b). Construing other similar Congressional enactments that were contemporaneous to the Bankruptcy Reform Act of 1978, the Court has acknowledged that the phrase "relates to" does not encompass remote or tenuous relationships.

For instance, in *Morales v. Trans World Airlines, Inc.*, 504 U.S. 976, 119 L.Ed.2d 157 (1992), the Court interpreted the provision in the 1978 Airline Deregulation Act (ADA) preempting "any [state] law, rule, regulation, or other provision having the force and effect of law *relating to* rates, routes or services of any air carrier . . . ." 49 U.S.C. App. 1305(a)(1) (emphasis supplied). The *Morales* Court defined the ADA "relating to" language as "having a connection with or reference to airline 'rates, routes or services.'" 119 L.Ed.2d at 167-68. But the Court also defined the outer limits of the Act's reach. The ADA would not apply if the state actions "affect [airline fares] in too tenuous, remote, or peripheral a manner . . . ." 119 L.Ed.2d at 172 (quoting *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 100 n. 21 (1983).

The Court's analysis in *Morales* was patterned after its earlier construction of a similar "relate to" clause in the Employee Retirement Income Security Act of 1974 (ERISA), 29 USC § 1001 *et seq.* ERISA preempts "any and all State laws insofar as they may now or hereafter *relate to* any employee benefit plan . . . ." 29 U.S.C. 1144(a) (emphasis supplied). In *Shaw v. Delta Air Lines, Inc., supra*, the Court ruled that a state law "relates to" an employee benefit plan "if it

has a connection with or reference to such a plan," *Id.* at 97, the same definition adopted in *Morales*. But the Court also set limits on the reach of ERISA in situations where the state actions "may affect employee benefit plans in too tenuous, remote or peripheral a manner." *Id.* at 100 n. 21.

Cases construing the reach of ERISA's "relate to" phrase are pertinent to the "related to" jurisdictional statute in the Bankruptcy Code because ERISA's statute has jurisdictional as well as preemptive ramifications. In a removed state court action having no other basis for federal jurisdiction, for instance, whether a state's actions "relate to" an employee benefit plan is a jurisdictional question. If the conduct alleged in the complaint is determined not to "relate to" an employee benefit plan, federal jurisdiction does not attach and the case must be remanded to state court. *See, e.g., Perkins v. Time Insurance Co.*, 898 F.2d 470 (CA5 1990) (fraud in the inducement by ERISA plan agent held not "related to" the plan, and case remanded to state court).

The lesson of *Shaw* and *Morales* is that the phrase "relates to" does not confer open-ended federal jurisdiction; at the very least, a perimeter of remoteness must be observed, as many other Circuits have recognized. Concern for comity with state courts should dictate that state claims having no possible binding effect on the bankruptcy estate be left for adjudication by the states.

POINT III

THE THREAT THIS CASE PRESENTS TO THE CONTINUED VITALITY OF ART. III, AND THE LONGSTANDING AND WIDE-SPREAD CONFLICT OVER THE PROPER REACH OF BANKRUPTCY SUBJECT-MATTER JURISDICTION, JUSTIFY THIS COURT'S ATTENTION

A major reform goal of the Bankruptcy Act of 1978 was to eliminate "wasteful litigation" over whether cases were "summary" actions subject to bankruptcy jurisdiction, or "plenary" actions that may be tried in District Court or state court. 1 *Collier on Bankruptcy* ¶ 3.01[1][b][iv], (15th rev. ed. 1994) (quoting comments of Rep. Edwards reported in 124 Cong. Rec. H11,108 (daily ed. Sept. 28, 1978)).

But in chopping off the one Hydra's head of "summary/plenary" jurisdiction, Congress has created two more, "related to/not related to" and "core/non-core." With only seminal guidance from this Court's *Marathon* opinions, the Courts of Appeal have applied conflicting standards and rationales to both jurisdictional issues, and have even strayed into constitutional error. The federal judiciary needs further guidance from this Court as to the proper perimeters of federal subject-matter jurisdiction and bankruptcy court jurisdiction over bankruptcy-related cases. Without such guidance, the courts may experience even more wasteful jurisdictional litigation than existed under the pre-1978 Banktruptcy Act.

It would not be desirable to allow the jurisdictional conflicts among the Circuits to continue. Many of the reported bankruptcy decisions involve major companies with national operations which have a certain degree of choice over the venue of their bankrutpcy filings. See 28 U.S.C. 1408. In addition, non-debtor litigants can often choose their venue for cases filed in or removed to District Court. *See, e.g.*, 28 U.S.C. 1409 and 28 U.S.C. 1452. The opportunity to choose different venues creates the opportunity to forum-shop for the Circuit with the most favorable jurisdictional rules, something the Court should discourage.

Given the long-standing nature of the intra-Circuit conflicts, it is unlikely that the conflicts will disappear with yet more time. Further study of the issues by the lower courts

would not be fruitful now, sixteen years after the adoption of the predecessor to 28 U.S.C. 1334(b), and eleven years after the adoption of 28 U.S.C. 157.

Finally, the threat that the Ninth Circuit's decision poses to the continued vitality of Article III makes it essential that the Court resolve this constitutional issue.

CONCLUSION

Congress' bankruptcy reform legislation, and its response to the Art. III constitutional issues the Court identified in *Marathon*, have resulted in uncertaintly over the proper relationships between the Bankruptcy Courts, the District Courts and state courts. The case at bar present the Court with the opportunity to clarify these important relationships.

For the foregoing reasons certiorari should be granted.

Respectfully submitted,

GREGORY A. HARTMAN
Counsel of Record

MICHAEL J. MORRIS
Bennett & Hartman
Suite 1600
851 S.W. Sixth Avenue
Portland, Oregon 97204
(503)227-4600

Counsel for Petitioners

April 12, 1995

APPENDIX

44 F.3d 1431

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: Harris Pine Millls, Debtor.	)	
GEORGE MAITLAND, NEIL ROBBLEE, and CARY GARMAN,	)	No. 93-35358
	)	D.C. No.
Plaintiffs-Appellants,	)	CV-92-01350-JO
v.	)	
	)	OPINION
JOHN MITCHELL; JOHN MITCHELL, INC., an Oregon corporation; and RODGERS HIGGINS, and Harris Pine Mills, Inc., an Oregon corporation,	)	
Defendants-Appellees.	)	

These consolidated appeals arose out of a trustee's sale of the assets of a company in bankruptcy. When the company proved to be less profitable than the purchasers had anticipated, they sued the trustee in state court. The trustee removed the action to federal district court, which in turn referred the case to the bankruptcy court. The bankruptcy court entered summary judgment in favor of the trustee on the purchasers' claims and in favor of the purchasers on the trustee's counter-claims. The district court affirmed the bankruptcy court's ruling, and both side have appealed. We

have jurisdiction under 28 U.S.C. § 158(d), and we affirm in part, reverse in part, and remand.

FACTS AND PRIOR PROCEEDINGS

Harris Pine Mills ("HPM"), an Oregon corporation, was a wood products conglomerate with annual gross sales during the early 1980s in excess of $50 million. HPM consisted of four divisions: (1) Logging--HPM owned timberlands in the Pacific Northwest, conducted extensive logging operations, and owned and operated a sawmill; (2) Retail--HPM owned and operated Harris Building Supply, a hardware store; (3) Furniture--HPM owned and operated several pine furniture manufacturing plants, from which it shipped unassembled indoor furniture components to assembly plants located throughout the country; and (4) Redwood--HPM manufactured and assembled redwood patio furniture.

On December 5, 1986, HPM filed a Chapter 7 petition in bankruptcy. The bankruptcy court appointed John Mitchell ("Mitchell") to act as trustee. One of Mitchell's first actions as trustee was to ask the court to convert the case from a Chapter 7 liquidation to a Chapter 11 reorganization. After granting the motion on December 10, 1986, the bankruptcy court appointed an Oregon corporation, John Mitchell, Inc. ("JMI"), to act as HPM's Chapter 11 trustee. Mitchell, who was JMI's president and principal shareholder, and Rogers Higgings ("Higgins"), a JMI employee, assumed HPM's chief management responsibilities; the rest of HPM's "management team" consisted of both current and retired HPM employees.

At the time JMI took over as trustee, HPM had inventory worth some $25 million, much of it consisting of unassembled furniture. JMI sought to reduce this inventory by assembling the furniture components for sale. JMI also began selling off the company's other assets: It sold HPM's sawmill, log inventory, and related timber contracts to Louisiana Pacific Corporation for approximately $3.8 million; it auctioned off

some of HPM's timberlands and additional timber contracts for another $3 million; and it sold HPM's Redwood Division to Little Lake Industries, Inc. for nearly $9.5 million. Meanwhile, JMI continued to operate HPM's Furniture Division while looking for a buyer.

In the Spring of 1988, Ligna Technologies, Inc. ("Ligna") expressed an interest in acquiring the Furniture Division for $8 million. Ligna assigned a certified public accountant, George Maitland ("Maitland"), to handle the investigation of the proposed sale. When it became apparent that Ligna would not acquire the Division, Maitland decided to buy it himself after leaving Ligna's employ. Meanwhile, Kroehler Cabinet Company, Inc. ("Kroehler") offered JMI 7.5 million for the Furniture Division in August 1988. The following month JMI announced its intention to sell the Division to Kroehler.

On September 22, 1988, Maitland and Neil Robblee ("Robblee"), an attorney, submitted a $7.5 million "upset bid" of behalf of Harris of Pendleton, Inc. ("HoPI"), a company Maitland and Robblee proposed to form for the purpose of acquiring the Furniture Division by way of a leveraged buyout. Because it now had two bids, JMI agreed to hold an auction for the Division. HoPI emerged as the successful buyer at $7.85 million, and acquired the Furniture Division on December 31, 1988.[1] Congress Financial Services ("Congress") financed HoPI's down payment and provided HoPI with a working capital line of credit. After a year in business, however, HoPI filed a petition in bankruptcy.

In August 1990, Maitland, Robblee, and their partner, Cary Garman[2] ("Garman") (collectively, "Plaintiffs") filed an

---

[1] Although the sale was made effective on December 31, 1988, it appears that the actual transfer of assets did not take place until January 27, 1989.

[2] Garman, a business broker and certified public accountant, was instrumental in helping Maitland and Robblee in their negotiations with JMI. Garman subsequently joined HoPI after agreeing to give Maitland and Robblee $50,000 in cash in exchange for 5% of HoPI's stock.

action in Oregon state court against JMI, Mitchell, and Higgins (collectively, "Defendants"), alleging fraud, negligence, and negligent misrepresentation surrounding HoPI's purchase of the Furniture Division. Upon removing the case to federal district court, Defendants sought to have the action referred to the bankruptcy court. Plaintiffs objected and moved to remand the case to state court. In November 1990, the district court ruled that it had jurisdiction over the action, denied the remand motion, and referred the case to the bankruptcy court as a core proceeding under 28 U.S.C. § 157(b).

Following Plaintiffs' filing of a Second Amended Complaint, in which they added a claim under Oregon's version of the RICO statute, and the assertion of various counterclaims by Defendants, both parties moved for summary judgment. The bankruptcy court ruled in favor of Defendants on Plaintiffs' motion and dismissed Plaintiffs' Second Amended Complaint, entered summary judgment in favor of Plaintiffs on Defendants' counterclaims, and awarded costs to Defendants. Both parties appealed to the district court, which affirmed the bankruptcy court's ruling in its entirety. Plaintiffs have timely appealed, and Defendants have timely cross-appealed, to this court.

DIRECT APPEAL (93-35358)
Federal Jurisdiction

Plaintiffs first argue that the district court erred by refusing to remand their action to state court, based on the district court's conclusion that federal jurisdiction existed over the case as a core proceeding in bankruptcy. We review *de novo* the court's acceptance of jurisdiction, while examining its factual determinations for clear error. *See Whitcombe v. Stevedoring Servs. of Am.*, 2 F.3d 312, 313 (9th Cir. 1993) (as amended).

Federal district courts have exclusive jurisdiction over all cases under Title 11 of the United States Code, and concurrent

jurisdiction over all civil proceedings arising under Title 11, or arising in or related to cases under Title 11. 28 U.S.C. § 1334(a), (b).[3] Those matters falling under the heading of cuncurrent jurisdiction (i.e., civil actions involving claims that arise under or in or are related to Title 11 proceedings) may be filed originally in state court, then subsequently removed by one of the parties to federal district court. 28 U.S.C. § 1452(a).[4] If the district court's local rules so provide, the removed action will then be referred automatically to the bankruptcy court. 28 U.S.C. § 157(a).[5] The non-removing party may in turn seek to have the case remanded to state court. 28 U.S.C. § 1452(b).[6]

---

[3] 28 U.S.C. § 1334(a) and (b) read, in their entirety:

> (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.
>
> (b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

[4] 28 U.S.C. § 1452(a) reads, in relevant part:

> (a) A party may remove any claim or cause of action in a civil action ... to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

[5] 28 U.S.C. § 157(a) reads, in its entirety:

> (a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

[6] 28 U.S.C. § 1452(b) reads, in relevant part:

> (b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order

Although concurrent jurisdiction claims under section 1334 are all treated the same for purposes of removal under section 1452, a distinction exists between those concurrent jurisdiction claims that "arise under" or "arise in" Title 11 on the one hand, and those that are merely "related to" Title 11 on the other hand. This distinction between "arising under," "arising in," and "related to" Title 11 has significance as a jurisdictional consideration:

> "Arising under" and "arising in" are terms of art. They are two of the three categories of cases over which district courts have jurisdiction under 28 U.S.C. § 1334(b). The third category includes cases "related to" a case under title 11. As the Fifth Circuit has explained,
>
> > Congress used the phrase "arising under title 11" to describe those proceedings that involve a cause of action created or determined by a statutory provision of title 11....The meaning of "arising in" proceedings is less clear, but seems to be a reference to those "administrative" matters that arise *only* in bankruptcy cases. In other words, "arising in" proceedings are those that are not based on any right expressly created by title 11, but nevertheless, would have no existence outside of the bankruptcy.

In re Wood, 825 F.2d 90, 96-97 (5th Cir. 1987) (footnotes omitted). The court concluded: "If the proceeding does not invoke a substantive right created

---

entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals...or by the Supreme Court of the United States....

> by the federal bankruptcy law and is one that could exist outside of bankruptcy it is not a core proceeding; it may be *related* to the bankruptcy because of its potential effect, but...it is an 'otherwise related' or non-core proceeding." *Id.* at 97.

Eastport Assocs. v. City of Los Angeles (In re Eastport Assocs.), 935 F.2d 1071, 1076-77 (9th Cir. 1991) (as amended) (emphases in original; footnote omitted).

Put another way, claims that arise under or in Title 11 are deemed to be "core" proceedings, while claims that are related to Title 11 are "noncore" proceedings. *See e.g. Robertson v. Isomedix, Inc. (In re Int'l Nutronics)*, 28 F.3d. 965, 969 (9th Cir. 1994) ("[c]ore proceedings are matters concerning the administration of the estate and rights created by title 11.") (internal citation and quotation omitted).

This distinction between core and noncore is important, because it determines how the claims must be treated:

> In noncore matters, the bankuptcy court acts as an adjunct to the district court, in a fashion similar to that of a magistrate or special master. In noncore matters, the bankruptcy court may not enter final judgments without the consent of the parties, and its findings of fact and conclusions of law in noncore matters are subject to de novo review by the district court....In contrast to the bankruptcy court's authority in noncore cases, the bankruptcy court may enter final judgments in so-called core cases, which are appealable to the district court. The standard for appeal of core matters of [sic] the district court is the same as in other civil matters appealed from the district court to the circuit courts of appeal. 28 U.S.C. § 158(c).

Taxel v. Electronic Sports Research (In re Cinematronics), 916 F.2d 1444, 1449 (9th Cir. 1990) (quoting *Piombo Corp.*

v. Castlerock Properties (In re Castlerock), 781 F.2d 159, 161 (9th Cir. 1986), in turn quoting *Production Steel, Inc. v. Bethlehem Steel Corp. (In re Production Steel)*, 48 B.R. 841, 844 (M.D. Tenn. 1985)). *Accord In re Int'l Nutronics*, 28 F.3d at 969; *see also* 28 U.S.C. § 157(b), (c).[7]

While the above explains the different treatment core and noncore proceedings receive at the hands of the courts, "no exact definition of the term[s] exist in the bankruptcy code. Rather, section 157(b)(2) contains a laundry list of core proceedings along with the admonition that core proceedings include, but are not limited to, the items listed." *In re Cinematronics*, 916 F.2d at 1449-50 (citations and internal

---

[7] 28 U.S.C. § 157(b) and (c) read, in relevant part:

> (b)(1) Bankruptcy judges may hear and determine all...core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.
>
> (2) Core proceedings include, but are not limited to–
>
> (A) matters concerning the administration of the estate; [and]
>
> * * *
>
> (O) other proceedings affecting the liquidation of the assets of the estate....
>
> (c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceedings, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge....
>
> (c)(2) [T]he district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and enter appropriate orders and judgments....

quotation omitted). This definitional failure notwithstanding, courts are not without guidance in this area.

The leading bankruptcy treatise notes that "Section 157(b)(2) contains fifteen illustrations of core proceedings. There are four convenient categories into which these illustrations can be put. These are (a) matters of administration, (b) avoiding actions, (c) matters concerning property of the estate, and (d) others." 1 William M. Collier, *Collier on Bankruptcy* ¶ 3.01[2][b][iii] at 3-40.1 (15th ed. 1994) ("*Collier's*"). In category (a) *Collier's* lists, *inter alia*, all "matters concerning the administration of the estate". *Id.* (quoting 28 U.S.C. § 157 (b)(2)(A)). Included within this category are "contract claims under state law when the contract was entered into postpetition." *Id.* at n.67a (citing relevant case law).

Category (d), referred to by *Collier's* as the "omnibus category," *see id.* at 3-45, includes "other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims." *Id.* (quoting 28 U.S.C. § 157(b)(2)(O)). While *Collier's* criticizes much of the case law that has emerged in this category, *see id.* at 3-48 through 3-50, it quotes with approval our holding in *In re Castlerock* that "state law and contract claims that do not specifically fall within the categories of core proceedings enumerated in 28 U.S.C. § 157(b)(2)(B)-(N) are related proceedings even if they arguably fit within the literal wording of the two catch-all provisions, sections 157(b)(2)(A) and (O)." *Id.* at 3-50 (citation omitted).[8]

---

[8] Thus, even if a state law claim that is removed to federal district court does not quality as a core proceeding under any of the fourteen categories listed in 28 U.S.C. § 157(b)(2)(A)-(N), it could still qualify as a noncore proceeding over which a district court could, in the exercise of its discretion, retain jurisdiction and refer the case to the bankruptcy court. *See* 28 U.S.C. §§ 1334(b), (c)(1); 1452(a).

Relying of 28 U.S.C. § 157(b)(2)(A) and (O), which state that "[c]ore proceedings include...matters concerning the administration of the estate...[and] other proceedings affecting the liquidation of the assets of the estate," the district court in the instant case held that federal jurisdiction existed over Plaintiffs' action as a core proceeding because Plaintiffs had sued Defendants for conduct undertaken in their capacity as HPM's trustee in bankruptcy, or as agents of JMI as the bankruptcy trustee, and these actions involved the sale of assets that were the property of HPM's bankruptcy estate, all of which had been subject to the supervision and approval of the bankruptcy court.

We have not previously faced the exact question presented by this appeal. In *In re Cinematronics* we held that a state law contract claim asserted against a non-debtor in his individual capacity that did not fall squarely within one of the examples listed at 28 U.S.C. § 157(b)(2)(B)-(N) could not be a core preceeding merely by virtue of the catch-all provisions of section 157(b)(2)(A) and (O). 916 F.2d at 1450 & n.6 (citing and discussing, inter alia, *In re Castlerock*, 781 F.2d at 162). In *In re Int'l Nutronics*, on the other hand, we held that federal antitrust claims asserted against a non-debtor that arose out of a bankruptcy proceeding could have been asserted in the bankruptcy court, even if that court later determined the claims to be noncore. 28 F.3d at 969.

Neither *In re Castlerock, In re Cinematronics, nor In re Int'l Nutronics* deal with the precise question raised in the instant appeal, and even *Collier's* offers little guidance on this point.[9] However, the clear majority of decisions from other courts that have touched on this issue hold that postpetition state law claims asserted by or against a trustee in bankruptcy

---

[9] *See e.g. Collier's* ¶ 3.01[1][c][vi] at 3-35 ("[W]ithout some tangible effect upon the administration of the case, or without some nexus to the bankruptcy case, a particular civil proceeding is not within the jurisdictional grant of section 1334(b).").

or the trustee's agents for conduct arising out of the sale of property belonging to the bankruptcy estate qualify as core proceedings.[10]

For example, in *Sanders Confectionery Prods., Inc. v. Heller Fin., Inc.*, 973 F.2d 474 (6th Cir. 1992), *cert. denied*, 113 S. Ct. 1046 (1993), the Court of Appeals for the Sixth Circuit held that

> [t]he claims against the trustee...would be core proceedings. While the specific causes of action, such as RICO, exist independently of bankruptcy cases, an action against a bankruptcy trustee for the trustee's administration of the bankruptcy estate could not. All claims against [the trustee]related to his conduct during the...bankruptcy, and should be considered core proceedings.

973 F.2d at 483 n.4. *Accord Garrity v. Leffler (In re Neuman)*, 71 B.R. 567, 573 (S.D.N.Y. 1987)(same). *But see Thomasson v. Amsouth Bank, N.A.*, 59 B.R. 997 (N.D.Ala. 1986)(trustee removed state court action to district court; district court remanded to state court because, *inter alia*, state court had already dealt with the merits of the case).

In *Arnold Print Works, Inc. v. Apkin (In re Arnold Print Works)*, 815 F.2d 165 (1st Cir. 1987), cited with approval in

---

[10] Most cases involving claims against bankruptcy trustees sued in state court appear to have resulted in the trustees' successful removal of the actions to federal district court. Cases finding state law claims to be noncore proceedings, however, do not involve trustees as defendants. *See e.g. Global Underwriting Mgt., Inc. v. Chatham Underwriting Mgt., Inc.*, 147 B.R. 601, 603(Bankr.S.D.Fla.1992)(plaintiffs sued debtor-corporation's president and sole shareholder in his individual capacity; citing *Cinematronics*); *Nationwide Roofing & Sheet Metal, Inc. v. Cincinnati Ins. Co. (In re Nationwide Roofing & Sheet Metal, Inc.)*, 130 B.R. 768, 775-76 (Bankr. S.D. Ohio 1991)(debtor sued insurer, *inter alios*); *O'Neil v. Sherman (In re TVR of America, Inc.)*, 123 B.R. 159, 162 (Bankr. D. Conn. 1991)(trustee sued former officer and shareholder of debtor corporation).

In re Int'l Nutronics, supra, the Court of Appeals for the First Circuit held that a postpetition state law contract claim asserted by the debtor-in-possession and arising out of the sale of the bankruptcy estate's assets fell within the literal wording of section 157(b)(2)(A),*i.e.*, "'matters concerning the administration of the estate,' because it involve[d] a claim that arose out of the administrative activities of [the] debtor-in-possession." 815 F.2d at 168. *See also* cases cited therein.

The case of *Honigman, Miller, Schwartz & Cohn v. Weitzman (In re DeLorean Motor Co.)*, 155 B.R. 521 (Bankr. 9th Cir. 1993), one of a series of actions that arose out of the DeLorean Motor Company's 1982 bankruptcy, is also illustrative. In 1984 the trustee in bankruptcy filed suit against John DeLorean and his attorney, Howard Weitzman, alleging a fraudulent transfer involving millions of dollars from DeLorean to Weitzman. DeLorean and the trustee settled their dispute and the trial court later ruled in favor of Weitzman in the trustee's lawsuit. Weitzman then brought a malicious prosecution action in state court against the trustee and the attorneys retained by the trustee to litigate the fraud action.

The Bankruptcy Appellate Panel ("BAP") for the Ninth Circuit concluded that, while a case should not be deemed a core proceeding "if it is a state law claim that could exist outside of bankruptcy and is not inextricably bound to the claims allowance process or a right created by the Bankruptcy Code[,]" Weitzman's state law claims against the trustee and the trustee's agents (viz., the lawyers retained by the trustee to sue DeLorean and Weitzman) constituted a core proceeding subject to federal jurisdiction.[11] 155 B.R. at 525 (citations omitted).

---

[11] More precisely, the BAP held that, because the Sixth Circuit had expressly declared in a related proceeding involving the same parties that the attorneys retained by the trustee were the trustee's agents and, therefore, entitled to the same protection afforded the trustee (who had already been dismissed from the plaintiff's action), *see Allard v. Weitzman (In re DeLorean Motor Co.)*, 991 F.2d 1236, 1241, 1243 (6th Cir. 1993), and Weitzman's state law claims against the attorneys fell within the scope of 28 U.S.C. § 1334(b),

Applying the above to the facts of this case, we conclude that the district court did not err by holding that Plaintiff's postpetition state law claims asserted against the bankruptcy trustee and his agents for conduct inextricably intertwined with the trustee's sale of property belonging to the bankruptcy estate involved a core proceeding subject to federal jurisdiction.

Summary Judgment

Plaintiffs contend that the district court erred by affirming the bankruptcy court's entry of summary judgment and dismissal of Plaintiffs' fraud and Oregon RICO claims. We examine the evidence in the light most favorable to the non-moving party to determine whether any genuine issues of material fact exist and whether the lower court correctly applied the relevant law. *Dowling v. Davis*, 19 F.3d 445, 447 (9th Cir. 1994).

Fraud Claims

Plaintiffs argue that substantial evidence existed from which a jury could have found that Defendants fraudulently concealed from Plaintiffs the Furniture Division's unprofitability, based on the following misrepresentations: (1) HPM's books were prepared on an accrual basis, when their payables were actually maintained on a cash basis; (2) the Furniture Division enjoyed a 20% gross margin rather that the actual figure of 5%; and (3) there had been no change in 1988 in the manner in which HPM did business, and the Furniture Division's inventory had been maintained at consistent levels.

Weitzman's action constituted a core proceeding under 28 U.S.C. § 157(b). 155 B.R. at 525.

In order to make out a claim of fraud or deceit under Oregon law,[12] Plaintiffs had to allege and show five things: First, that Defendants falsely represented a material fact; second, that Defendants' misrepresentation was knowingly made, or made with an insufficient basis for asserting its truth (scienter); third, that the misrepresentation was made with the intent to induce Plaintiffs to act or refrain from acting; fourth, that Plaintiffs justifiably relied on Defendants' misrepresentation; and fifth, that Plaintiffs suffered resultant damage. *See Riley Hill Gen'l Contr., Inc. v. Tandy Corp.*, 303 Or. 390, 405, 737 P.2d 595, 604 (1987); *Gregory v. Novak*, 121 Or. App. 651, 654, 855 P.2d 1142, 1143 (1993).

Because Defendants timely filed a motion for summary judgment that was amply supported by affidavits and similar materials, Plaintiffs were required to make a properly supported response setting forth specific facts showing the existence of a genuine issue for trial or risk having summary judgment entered against them. *See* Fed. R. Civ. P. 56(c), (e). "When the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts....Where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986) (footnote, internal citations and quotations omitted).

Plaintiffs failed to demonstrate the existence of a genuine issue of material fact with respect to any of their fraud claims. The materials before us provide ample proof that Plaintiffs, all of whom were sophisticated businessmen (two CPAs and an attorney) and experienced in operating distressed companies, understood that they could not rely on the purported accuracy of HPM's older accounting records until a new physical inventory of the Furniture Division had been taken.

---

[12] It is undisputed that Oregon law is controlling.

Moreover, the materials do not support Plaintiffs' contention the Defendants made representations upon which Plaintiffs could reasonably rely with respect to the matters covered by the disclaimer. Finally, Plaintiffs were given virtually unimpeded access to all information relating to HPM's operations and employees, and could not have failed to observe, for example, that many expenses were reported on a cash basis, not on an accrual basis. Plaintiffs' arguments concerning accumulated payable and held checks, alleged discrepancies in HPM's 2015 reports, and their purported reliance on a gross margin figure that is belied by their own sworn testimony, are simply without merit.

By their own admission, Plaintiffs were sophisticated businessmen (or "investors," to use their term of choice) who acquired "as is" a business that was in bankruptcy. Accordingly, and from the materials before us we conclude that the district court did not err by affirming the bankruptcy court's entry of summary judgment in favor of Defendants on Plaintiffs' fraud claims.

Oregon RICO Claim

Plaintiffs also contend that the district court should not have affirmed the bankruptcy court's *sua sponte* entry of summary judgment in favor of Defendants on Plaintiffs' Oregon RICO claim because, *inter alia*, Plaintiffs were not given prior notice of the court's intent to rule on that claim. An essential element of Plaintiff's Oregon RICO claim is that Defendants defrauded them. In the light of our conclusion above, it necessarily follows that Plaintiffs' Oregon RICO claim must also fail. *See California Arch. Bldg. Prods, Inc. v. Franciscan Ceramics, Inc.*, 818 F.2d 1466, 1469 (9th Cir. 1987) (plaintiffs' failure to show that genuine issue of material fact existed on their fraud claim meant that summary judgment was appropriate on their RICO claim as well), *cert. denied*, 484 U.S. 1006 (1988). As for Plaintiffs' contention that the

bankruptcy court should not have entered summary judgment *sua sponte*, the law is clear that, while a court may not ordinarily enter summary judgment on a claim without giving the losing party ten days' notice and an opportunity to present new evidence, "[a] district court may grant summary judgment without notice if the losing party has had a full and fair opportunity to ventilate the issued involved in the motion." *United States v. Grayson*, 879 F.2d 620, 625 (9th Cir. 1989) (citations and internal quotation omitted). Because Plaintiffs had a full and fair opportunity to ventilate the issue, the district court did not err by affirming the bankruptcy court's ruling on this issue.

CROSS-APPEAL (93-35385)
Dismissal of Counterclaims

Defendants contend in their cross-appeal that the district court erred by affirming the bankruptcy court's entry of summary judgment and dismissal of Defendants' counterclaims for breach of contract and conversion.[13] The gist of their breach of contract argument is that substantial evidence existed from which a jury could have found that JMI's willingness to entertain Maitland and Robblee's "upset bid" was based on a promise to capitalize HoPi with at least $600,000 in equity, a promise Plaintiffs never kept. Both the bankruptcy and district courts concluded that, because there was no formal, written capitalization obligation in the many pages of the purchase agreement between JMI and HoPI, no such contract existed. Defendants argue, however, that the

---

[13] Defendants asserted a total of five counterclaims, alleging (1) breach of contract, (2) promissory estoppel, (3) quantum meruit, (4) withdrawal of assets, and (5) conversion. The bankruptcy court ruled on all five of these issues, and the district court discussed all five while noting that the parties had only briefed the first, fourth, and fifth of these issues. Defendants have abandoned all but the first (breach of contract) and fifth (conversion) issues on appeal to this court.

purchase agreement is not the agreement to which there are referring; rather, Defendants insist that, absent an ironclad capitalization agreement between Maitland and Robblee on the one hand, and JMI on the other, JMI as trustee in bankruptcy would never have entertained the then-nonexistent HoPI as a serious contender for the Furniture Division, since JMI already had a *bona fide* offer of $7.5 million from an established firm, *viz.*, Kroehler.

With respect to the conversion argument, Defendants contend that Plaintiffs, *inter alia*, used HoPI funds to satisfy a $120,000 debt owed to American Entertainment Centers ("AEC"), Maitland's corporation, and to make payments on Robblee's note, used as collateral for a $200,000 line of credit that formed part of Robblee's capital contribution to HoPI. The district court upheld the bankruptcy court's entry of summary judgment in favor of Plaintiffs on the ground that it found no evidence "that JMI declared HOPI to be in default, and the payment to AEC (one of the assets used for plaintiffs' own benefit) was made before the disputes between HOPI and JMI arose."

In neither their original nor their second amended complaint did Plaintiffs name HoPI as a party-plaintiff, nor did they sue on behalf of HoPI. By the same token, Defendants asserted their counterclaims against Plaintiffs (specifically, Maitland and Robblee) in their individual capacities, and not against HoPI. Accordingly, we have some difficulty with the notion that Defendants' counterclaims were really asserted against the shell corporation rather that against the corporation's principals. From our review of the materials provided, we conclude that genuine issues of material fact exist on both the breach on contract and conversion counterclaims, and that summary judgment was improvidently granted on these issues. Accordingly, we must set aside the entry of summary judgment with respect to those two counterclaims and remand for further proceedings.

CONCLUSION

We AFFIRM the districts court's conclusion that it had jurisdiction over Plaintiffs' action as a core proceeding in the bankruptcy, and we AFFIRM the district court's upholding of the bankruptcy court's entry of summary judgment and dismissal of all of Plaintiffs' claims against Defendants. We REVERSE the district court's upholding of the bankruptcy court's entry of summary judgment and dismissal of Defendants' breach of contract and conversion counterclaims, and REMAND for further proceedings.[14]

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED. Each party shall bear their own costs on appeal.

---

[14] In the light of our ruling, we need not and do not reach the merits of Plaintiffs' argument that the district court erred by awarding costs to Defendants.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

GEORGE MAITLAND, NEIL ROBBLEE, and CARY GARMAN,	)	
	)	Civil No.
Plaintiffs,	)	90-965-FR
	)	
v.	)	
	)	OPINION
JOHN MITCHELL; JOHN MITCHELL, INC., an Oregon corporation; and RODGERS HIGGINS,	)	
	)	
Defendants.	)	
	)	

Michael J. Morris
Bennett & Durham
851 S.W. Sixth Avenue, Suite 1600
Portland, Oregon 97201-1376

Attorneys for Plaintiffs

Mark L. Cushing
Michele L. Friedman
Ball, Janik & Novack
One Main Place, Suite 1100
101 S.W. Main Street
Portland, Oregon 97204

Attorneys for Defendants

FRYE, Judge:

The matters before the court are 1) the motion (#3) of defendants to refer this case to the United States Bankruptcy Court for the District of Oregon for resolution; and 2) the motion (#7) of plaintiffs to remand this case to the Circuit Court of the State of Oregon for the County of Multnomah.

BACKGROUND

On December 8, 1986, defendant John Mitchell, Inc. was appointed trustee in bankruptcy in a case entitled *In re Harris Pine Mills*, Case No. 386-06604-P11, filed in the United States Bankruptcy Court for the District of Oregon. Defendant John Mitchell is the owner of John Mitchell, Inc. Defendant Rodgers Higgins is an employee of John Mitchell, Inc.

On December 31, 1988, as a part of the administration of the bankruptcy estate, John Mitchell, Inc., as trustee of the bankruptcy estate, sold the furniture division of John Mitchell, Inc. to Harris of Pendleton, Inc. Harris of Pendleton, Inc. filed a petition in bankruptcy on December 18, 1989. The case continues in bankruptcy.

In August, 1990, plaintiffs, who are shareholders in Harris of Pendleton, Inc., brought an action in the Circuit Court of the State of Oregon for the County of Multnomah alleging common law fraud, negligence, and nondisclosure against the trustee in bankruptcy, John Mitchell, Inc.; John Mitchell; and Rodgers Higgins.

Defendants filed a notice of removal to this court on September 19, 1990. Defendants thereafter filed the pending motion to refer this action to the United States Bankruptcy Court. Plaintiffs oppose the motion and move the court to remand the action to the Circuit Court of the State of Oregon for the County of Multnomah.

Defendants contend that this action is a core proceeding under 28 U.S.C. § 157(b)(2)(A) and should be resolved in the bankruptcy court. Plaintiffs assert that this action is not a core

proceeding, and that there is no basis for this court to exercise jurisdiction over this action.

ANALYSIS

28 U.S.C. § 157(b)(2) provides, in relavant part: "Core proceedings include, but are not limited to -- (A) matters concerning the administration of the estate. . . [and] (O) other proceedings affecting the liquidation of the assets of the estate." If this action involved a breach of the contract of sale between John Mitchell, Inc., the trustee in bankruptcy, and Harris of Pendleton, Inc., this would be a core proceeding. While this is a tort action, plaintiffs bring this action against John Mitchell, Inc., the trustee in bankruptcy, involving a sale made by John Mitchell, Inc. as part of the administration of the bankruptcy estate. The cause of action arises under state law but involves the administration of the bankruptcy estate in that the trustee in bankruptcy has been named as a defendant and the resolution of this case will directly affect the liquidation of the assets of the bankruptcy estate. The court concludes that this action is a core proceeding and should be referred to the bankruptcy court.

CONCLUSION

Defendants' motion to refer this case to the United States Bankruptcy Court (#3) is granted; and 2) plaintiffs' motion to remand this case to the Circuit Court of the State of Oregon for the County of Multnomah (#7) is denied.

DATED this 14 day of November, 1990.

HELEN J. FRYE
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

GEORGE MAITLAND, NEIL ROBBLEE, and CARY GARMAN,	)	
	)	Civil No.
Plaintiffs,	)	90-965-FR
v.	)	
	)	ORDER
JOHN MITCHELL; JOHN MITCHELL, INC., an Oregon corporation; and RODGERS HIGGINS,	)	
Defendants.	)	

IT IS HEREBY ORDERED that defendants' motion to refer this case to the United States Bankruptcy Court (#3) is GRANTED; and 2) plaintiffs' motion to remand this case to the Circuit Court of the State of Oregon for the County of Multnomah (#7) is DENIED.

DATED this 14 day of November, 1990.

HELEN J. FRYE
United States District Judge

UNITED STATES BANKRUPTCY COURT
District of Oregon
1001 S.W. 5th Avenue, #900
Portland, Oregon 97204

April 16, 1991

Mr. Leon Simson
Attorney at Law
Suite 1100
101 S.W. Main Street
Portland, Oregon 97204

Mr. Michael J. Morris
Attorney at Law
Suite 1600
851 S.W. Sixth
Portland, Oregon 97201

Re: *Maitland, et al. v. Mitchell, et al.*
Adv. No. 90-3536 / Case No. 386-36604-P11

Dear Counsel:

I must deny the defendants' motion for summary judgment. The following will briefly outline the facts which I considered and my reason for denying the motion.

John Mitchell, Inc. was the trustee of the bankruptcy estate of Harris Pine Mills. In their complaint, the plaintiffs allege that:

> During the fall of 1988 defendant Mitchell negotiated with plaintiffs for the purchase and sale of the assets of the furniture division of Harris Pine Mills. At all material times defendant knew that plaintiffs intended to form a new corporation to purchase the assets. On October 3, 1988 defendants accepted plaintiffs' offer for the purchase of the assets.

> On December 9, 1988 plaintiffs formed Harris of Pendleton, Inc. ("HOPI"), an Oregon Corporation, to purchase the assets. . . . . The sale of the furniture division of Harris Pine Mills was closed effective December 31, 1988.

The first claim for relief alleges that the defendants fraudulently induced plaintiffs to form a corporation to purchase the assets through false representations regarding the financial condition of Harris Pine Mills. The next claim alleges negligent misrepresentation based upon the same facts. The third claim for relief is based upon negligence in connection with the same representations. Plaintiffs measure their damages by the amount of their contributions to HOPI.

The defendants initially moved for summary judgment on all three claims for relief. At hearing on April 1, 1991, the court ordered that the motion be held in abeyance as to the fraud claim pending further discovery. The defendants agreed that, for the purpose of this motion, the court may deem all allegations in the complaint as true, and that no further disputed facts should be considered in deciding the motion.

The defendants contend that the negligence claim and the negligent misrepresentation claim are one in the same. I agree that the negligence claim is redundant. The proper procedural device for removing redundant matter from a pleading is to strike that portion of the pleading under Bankr. R. 7012 and F.R.C.P. 12(f). Under that rule, the court may act on its own initiative. I therefore order plaintiff's negligence claim stricken as redundant.

A threshold issue is whether the defendants owed a duty to plaintiffs. The contract for the sale of assets ("contract") was between HOPI and John Mitchell, Inc. as trustee. A shareholder generally does not have standing to seek redress for an injury to the corporation. An exception exists to that rule where the third party owed a separate duty to the stockholder. *EMI Ltd. v. Bennett*, 738 F.2d 994, 996 (9th

Cir. 1984), *cert. den.* 469 U.S. 1073; *Weiss v. Northwest Acceptance Corp.*, 274 Or. 343, 546 P.2d 1065, 1069 (1976). In this case, the plaintiffs have brought themselves within the exception by asserting that the defendants, through false representations, induced plaintiffs to form a corporation for the purpose of purchasing the assets. *Sutter v. General Petroleum Corporation*, 28 Cal.2d 627, 170 P.2d 898 (1946).

The defendants attempt to distinguish *Sutter* because in that case, the initial negotiations were with plaintiff in his individual capacity, whereas in the instant case the plaintiffs intended to form a corporation as the purchaser from the outset. In essence, the defendants argue that because the plaintiffs at all times intended to form a corporation to purchase the assets, the defendants had no duty to the individuals who would create and fund the corporation. The defendants have cited no authority for that proposition, and I am aware of none. I believe that *Sutter* stands for the proposition that under certain circumstances, inaccurate representations which are known to be the basis of an investment decision may be actionable by the investor. I agree with that proposition. Accordingly, I believe that the allegations state a cause of action by the plaintiffs.

The defendants next argue that the disclaimer regarding representations contained at p. 18, ¶ 9.3 of the sales agreement protects them from any liability for negligent misrepresentation or negligence. The plaintiffs respond that, since they were not parties to the contract, they are not bound by the disclaimer. The defendants reply that the parties intended the contract, including the disclaimer, to bind the shareholders. To prove that intent, they point to ¶ 15.3 of the contract, which provides the following:

> Entire Agreement. THIS AGREEMENT AND ALL OF THE CONTRACTS, AGREEMENTS, INSTRUMENTS AND OTHER DOCUMENTS REFERENCED IN THIS AGREEMENT

> CONSTITUTE THE COMPLETE AND EXCLUSIVE STATEMENT OF THE AGREEMENT BETWEEN THE PARTIES CONCERNING THE SUBJECT MATTER OF THIS AGREEMENT, AND SUPERSEDE ALL ORAL OR WRITTEN PROPOSALS, PRIOR AGREEMENTS AND OTHER PRIOR COMMUNICATIONS BETWEEN THE PARTIES, INCLUDING SPECIFICALLY THE LETTER OF INTENT DATED SEPTEMBER 22, 1988 TO SELLER FROM NEIL H. ROBBLEE AND GEORGE MAITLAND.

The contract was signed only by Robblee, in his capacity as President of HOPI. The September 22, 1988 letter referred to in ¶ 15.3 is a letter from Robblee and Maitland to the trustee which states as follows:

> Neil Robblee and George Maitland propose to form a new corporation ('buyer') to be controlled by them, to purchase certain assets of Harris Pine Mills from Harris Pine Mills and/or John Mitchell, Inc., Trustee ('Seller') in accordance with the following terms and conditions.

There followed a detailed proposal regarding the purchase of assets. Paragraph 13 of the letter states that it "shall not be construed as a contract or as an offer to enter into a contract." The record indicates that from the inception, plaintiffs intended to form a corporation as the purchaser, and were acting on behalf of the unformed corporation. No party has cited any authority which would provide guidance regarding the effect of the disclaimer on the individual shareholders under such circumstances, and I was unable to find any cases involving similar facts. Nevertheless, if the plaintiffs and defendants intended that all prior discussions between the individual

shareholders and the defendants were merged into the contract, that intent will control.

I can only grant summary judgment if there is no genuine issue of material fact. Bankr. R. 7056; Fed. R. Civ. P. 56(c). In the instant case, there is a genuine issue of material fact regarding whether, under ¶ 15.3, the parties intended the contract to supersede all representations made to the plaintiffs in their individual capacities. I note that the contract itself was signed only by Robblee on behalf of HOPI. There is no indication that any of the other plaintiffs were aware of all terms of the contract. There is no indication that Robblee had authority to bind the other plaintiffs in their individual capacity. Accordingly, under the present record I cannot say that the plaintiffs intended the contract to supersede all prior understandings and representations of the defendants.

Defendants also argue that plaintiffs cannot, on one hand, insist that the corporation be the purchaser (thereby obtaining the benefits of utilizing a corporate entity), and on the other hand avoid certain contractual limitations by seeking remedies in their individual capacity. The appeal of that argument, which appears to be an equitable estoppel argument, necessarily depends upon all the circumstances surroudning the execution of the agreement. Since those facts have not been sufficiently developed in the current record of undisputed facts, a genuine issue of material fact exists and I cannot grant summary judgment.

I ask Mr. Morris to present the order.

Very truly yours,

ELIZABETH L. PERRIS
Bankruptcy Judge

PORTIONS OF TRANSCRIPT OF MAY 7, 1992 HEARING BEFORE THE HONORABLE THOMAS T. GLOVER , VISITING U.S.B.J.

Let me first take the plaintiffs' motion for summary judgment on the counterclaims that's before the court. First of those is a request that the court dismiss the counterclaim based upon breach of contract concerning the capitalization of the purchaser. I'll grant the motion for summary judgment. The reason is very simple. When one looks at the purchase and sale agreement in this particular case which is the contract, it does not say anything about the capitalization of the new venture. There is certainly some presentation of qualifying information way back at the bidding stage in this particular matter. But in order for this to be an actionable counterclaim it must be found in the contract between these parties and for purposes of making that decision I am including the individual plaintiffs as being considered in the context of that contract. But it's not there and it can't be actionable.

Secondly, the counterclaim which is based upon promissory estoppel. In order for this to lie as far as a counterclaim is concerned the court must be satisfied that a promise was made, relied upon to detriment, that means damages. There's no evidence in this record that connects the capitalization promise and when I acknowledge it's promise that doesn't mean it ended up in the contract but it certainly was involved in the bidding procedure. There's no causal connection from any of the evidence on this record that ties it to damages which might have been suffered by the defendants as the sellers of this particular business.

The claim relating to quantum meruit, there's no significant evidence of any at all in this record to indicate that the purchasers were ultimately benefitted in such a way that the court should recognize any kind of equitable claim that would be dismissed.

The counterclaim which is based upon the, I'll call it undercapitalization or insufficient payment for shares, which is often referred to as "watered stock" I think, is taken care of by the Uniform Act; directors have the ability to value these kinds of things in whatever way they want to and it seems to me that that isn't a separate and distinct claim that's actionable and that particular counterclaim is dismissed.

The final one relates to conversion and I frankly thought we had some issues there. There are two issues involving conversion; one is the matters relating to the payment of AEC bills. Those particular payments I think were really contemplated in the understanding of these parties that these two businesses were to be combined. When you combine the assets, why, arguably it's reasonable to contemplate that you combine liabilities. And at least as far as ordinary course liabilities, it seems to me that those would not be in violation of the security agreements which were retained by the defendants here as sellers of these particular assets. The matter concerning the letter of credit, again, I thought was something actionable but when I go back and look at Judge Perris's decision in the related matter I don't think we're going to necessarily have collateral estoppel on all issues, but I think it's really the law of the case. She found that that was an ordinary type of expense with respect to this business and that disposes of it. So all of those counterclaims are dismissed.

Now let's move to the motion for summary judgment as filed by the defendants. Earlier in this case the court denied summary judgment at a time when there was a very limited record. At that point in time the court, at least through some of the arguments had questions involving standing and it had the questions of the contract relating to the fact that the trustee was indicating that there were no representations made in this particular setting. With that alone the court denied summary judgment. But now let's take a look at those facts anew in the context of everything else that's been developed in the case.

What do we have here. We have a situation where a trustee in bankruptcy is operating a business. It is not historically a business that is operated by the trustee in bankruptcy; in fact, by nature trustees in bankruptcy operate somebody else's business if they operate them at all. We have a situation where the trustee found the purchaser or found a purchaser which was not the plaintiffs in this particular case and the trustee noticed out a sale of the business assets for 7 and a half million dollars. Then and only then did the plaintiffs come forth and say we want to bid, we want to match the offer. And they made a proposal that brought them into the confines of the bankruptcy court as far as participation and what the trustee then recommended to the court which was an auction of these assets. So we've got a trustee in bankruptcy operating a business who finds another purchaser and then the plaintiff comes in and says hey, I'm interested and then we have an auction and the plaintiff buys the assets at auction. Well, we're not quite done with negotiations and there have been review of financial documents before and presumably, presumably actually after this date of the auction. But we come up with an agreement that says in it the trustee is not representing anything concerning this business. In fact plaintiff doesn't like that very well. But that's what the deal was and it's in great big print. Now we've got to be careful in enforcing those kinds of clauses in the law because one can't, for instance, exculpate oneself from fraud through putting those kinds of things in agreements so we don't throw it out altogether but it's a statement that the trustee is making to these sophisticated purchasers, two accountants and a lawyer, and they've had experience in this business, that says hey, you need to take a look at this thing. It's been in bankruptcy and I've been operating it and I'm not standing by any representation. You bought it at auction so be careful. It's more than that, it's saying look, if you want to buy this thing you really need to make you own decisions on it. That's really what the trustee's saying. Now in that context, why should

the trustee defraud anybody? He already had another purchaser. What difference does it make? It seems to me that if I'm going to allow a fraud claim to subsist in this case something's got to smell bad, which is the old rule of clear and convincing evidence, which no longer applies in dischargability cases, but I don't think the law is too different under Oregon law, that the court has to be convinced as if I were compelled to find a fraud here. There's no concealmeant or fraud in this particular case. The trustee says, look I've been using this particular formula for estimating. I'm reasonably satisfied with it but I'm telling you I'm having trouble with the physical inventory counts in the business. Now that's not a situation that the court in any way, shape or form should allow this case to go to a trier of fact, a jury particularly, but just a trier of fact as the court in general, and a full blown trial. We'd be wasting our time. There's no fraud here. I'll dismiss that granting the defendants' summary judgment motion on that issue.

You didn't bring up the RICO matters in this particular case but I'm going to dismiss those on my own motion. It seems to me in this country that we have now tried to use the RICO statute under circumstances where it frankly didn't belong. It was developed to deal with racketeers and it's improvident at best for that to be in this case.

How about the negligent representation area? Frankly I would have thought the contract itself would take care of that but let's look at the representations that the trustee might arguably have made in this particular situation. Well this is accrual basis accounting system. Okay, well it wasn't quite that in all respects. The only thing is, these purchasers, who've had experience in these industries, need to look at those records. They've got an affirmative duty in my view to not sit back and simply say, oh, well, that's an accrual system. And the reason is when you're manufacturing something, particularly furniture, and I don't need to tell these purchasers that, they know it, you need to have a much more precise

understanding and you have a duty to go in and look at how the inventory is being costed out, what's going into it, what it's costing. And even if they weren't keeping accrual records there is no evidence on this record that they were accumulating receivables or payables. Where's the evidence? They slop over another month. They're taking trade discounts. Where's the evidence in this record that they're over some period of time accumulating accounts payable? I must be missing something here but I don't see it. I mean we've got to have a situation where there's a pattern, where they're holding off creditors or a pattern where they're deferring them more and more. Trustee's taking discounts on purchases of a lot of hard goods in this particular area and even if there's a problem with all of that for what purpose is the purchaser looking at the accounts payable figure? Well, the purchaser's looking at it not in terms of the balance sheet for accounts payable, because they're buying assets, they're not buying, you know, the stock in the business where the other side of the balance sheet's important. It only relates to what goes on the income statement. And we've already got problems there because we have plugged figures in most months based upon an inventory formula. But putting that aside, if the level of accounts receivable is fairly constant in each month, and it may not be exact, then it doesn't make any difference whether you pay it in month 1 or month 2. At least as far as the purpose that the purchasers were employing that financial statement. They were trying to figure out the cost of goods sold against sales, gross profit. Why? Because they're going to do a bunch of other things to the rest of this business anyway. They didn't care about G&A, they didn't care about any of the indirect costs. Oh, they would have an interest in some of them like the lease payments under leases that were going to be assumed and signed. But that's all. If you have a fairly constant flow, even though it is a month late, and I query whether it's really a month late in a lot of these instances, why, it's not going to distort that figure. And I'm not convinced that in any way,

shape or form that these parties were in any way mislead by all of that.

Now about the junk inventory. Seems to me that at very least these are supposed to be furniture people. They know this stuff. They hired Touch to supervise at least the count of the inventory at the end of December of 1988. They should have known what was in that inventory. They had lots of time. The deal didn't close for 27 more days to say, hey, under our original offer we told you we weren't going to buy junk. We're not buying obsolete inventory. And so we're not going to pay for that. And that would have been worked out against the purchase price. And the fact that there was a delayed closing, actually two closings involved here, seems to me to unquestionably indicate that those matters, again, were something that the deal itself protected the purchasers. And it's only now after the commencement of this action, apparently, that the purchasers raise complaints pertaining to those sorts of matters. I'm not sure I fully understand all of the problems with respect to the estimating formula that the trustee was using and how that tied in to actual count. It may be that the trustee was off somewhere in this estimating. I don't think that ripens to a representation because these are formula matters and the trustee let the purchasers know that he didn't like the old one, he was trying to put in his own system, and yet one must still realize that this was an estimating situation. How can experienced furniture people, you know, a lawyer and a couple of accountants, rely on a trustee who's been operating a business for maybe 12-18 months at the most, when they know this business, and close their eyes and say that they relied on all of that. Under the circumstances of this kind of a transaction that makes absolutely no sense to me. For the foregoing reasons the court grants the defendants' motion for summary judgment, dismissing the complaint of the plaintiffs with prejudice. Counterclaims are dismissed with prejudice. Counsel may prepare appropriate orders reflecting the court's ruling. I would suggest that they should

be very simple orders. I will not make specific findings on them If you want to take it up on appeal, why, the courts always look at the whole record anyway and I don't think the making of findings, unless they're on partial summary judgments, by the court assists in the appellate process. Questions?

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

GEORGE MAITLAND, et al.,	)
	) Civil No. 92-1350-
Appellants,	) JO
	) Bkcy No. 386-
v.	) 36604-P11
	) Adv. No. 90-3536
JOHN MITCHELL, et al.,	)
	) OPINION AND
Appellees.	) ORDER
	)

JONES, Judge:

This case, which involves a bankruptcy trustee's sale of a furniture manufacturing operation, is on appeal from a ruling by the bankruptcy court granting summary judgment for defendants on plaintiffs' claims and for plaintiffs on defendants' counterclaims.

This case is awash in red ink with plaintiffs hoping this litigation will stanch its flow. However, I agree with Bankruptcy Judge Glover that the plaintiffs fail to make out a case of common law fraud. The bottom line is that purchaser plaintiffs, two CPAs and a lawyer, were well aware they were dealing with a financially troubled company; they gambled and lost. The defendants' claims are equally infructous. I affirm the ruling of the bankruptcy court for the reasons put forth below.

BACKGROUND AND FACTS

Harris Pine Mills ("HarRis Pine") is an Oregon corporation comprised of four operations: (1) a furniture

division; (2) a redwood division, which manufactured patio furniture; (3) Harris Building Supply, a hardware store located in Pendleton; and (4) logging.

When Harris Pine filed a Chapter 7 petition for bankruptcy, John Mitchell, Inc. ("JMI") was appointed trustee. The trustee, in turn, sucessfully petitioned the court to convert the case to a Chapter 11 reorganization.[1]

As part of the reorganization, JMI operated the furniture division, with John Mitchell and Rodgers Higgins assigned to manage the manufacturing operation.

The trustee tried to sell the furniture division in 1988, at one point negotiating with a company called Lignatech. George Maitland, a CPA, was involved in investigating the purchase on behalf of Lignatech, which was unsuccessful in buying the business. In September of 1988, the trustee gave notice of intent to sell the furniture division to Kroehler Cabinet Company. Maitland, who by then had ended his relationship with Lignatech, and lawyer Neil Robblee submitted an "upset bid." The trustee held an auction and Maitland and Robblee were the highest bidders. Cary Garman, a business broker who is also a CPA, assisted the parties during the sale negotiations. The parties eventually agreed that Garman, through a stock purchase, would become one of the owners of Harris of Pendleton, Inc. ("HOPI"), the corporation formed to purchase the assets of the furniture division.

During the sale negotiations, defendants supplied plaintiffs with financial statements for Harris Pine for periods before and after the bankruptcy filing, as well as with the monthly reports required by Bankruptcy Rule 2015. Plaintiffs allege that defendants made misrepresentations during this

---

[1] Defendants describe the chronology differently; they say Mitchell was appointed Chapter 7 trustee and moved to convert the case to Chapter 11, at which time JMI was appointed Chapter 11 trustee. The difference does not affect this decision.

negotiations period and that those misrepresentations form the basis of plaintiffs' claims.

The sale of the furniture division to HOPI was effective as of Dec. 31, 1988. The down payment was financed by Congress Financial Services ("Congress"), which also gave HOPI a line of credit. After a year in business, HOPI filed for bankruptcy.

This action originated in Multnomah County Circuit Court, where Maitland, Robblee and Garman sued JMI, Mitchell and Higgins for fraud and negligent misrepresentation in connection with the sale of the furniture division to HOPI. Defendants removed the case to this court and moved to refer it to the bankruptcy court. Plaintiffs moved to remand. In November, 1990, Judge Frye denied plaintiffs' motion to remand and granted defendants' motion to refer.

Defendants filed counterclaims, alleging that plaintiffs breached their promise to put money into HOPI and that plaintiffs converted HOPI funds for their own use. Plaintiffs amended their complaint twice, first adding Harris Pine[2] as a defendant and then adding a claim under ORICO.

Both plaintiffs and defendants filed summary judgment motions. Judge Thomas T. Glover, a visiting bankruptcy judge, granted summary judgment in favor of defendants on plaintiffs' claims and in favor of plaintiffs on defendants' counterclaims. Plaintiffs appeal to this court from that ruling, and defendants cross-appeal.

STANDARDS OF REVIEW

When hearing appeals of core matters from the bankruptcy court, this court applies the same standard of review the circuit courts of appeal use when reviewing district court civil decisions, pursuant to 28 U.S.C. § 158(c). *In re*

---

[2] The proper party to join would be the estate of Harris Pine, because of the bankruptcy proceedings. The court reads the pleadings before it as joining the estate but for simplicity will refer to Haris Pine as the defendant.

Castlerock Properties, 781 F.2d 159, 161 (9th Cir. 1986). The Ninth Circuit Court of Appeals reviews a district court's grant of summary judgment *de novo*. *T.W. Elec. Service, Inc. v. Pacific Elec. Contractors Ass'n*, 809 F.2d 626, 629-30 (9th Cir. 1987). "Therefore, when reviewing a grant of summary judgment, this court sits in the same position as the district court and applies the same summary judgment test that governs the district court's decision." *Id.*

If no factual issues exist for trial, then summary judgment is proper. The party opposing the motion must show that the fact in contention is material, that is, that it might affect the outcome of the suit under applicable law. *Lindahl v. Air France*, 930 F.2d 1434, 1436-37 (9th Cir. 1991).

The opposing party's evidence is to be believed, and all reasonable inferences that may be drawn from the facts in front of the court must be drawn in the light most favorable to the nonmoving party. *Id.* However, the nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 106 S.Ct. 1348, 1356 (1986).

> [T]he nonmoving party may not merely state that it will discredit the moving party's evidence at trial and proceed in the hope that something can be developed at trial in the way of evidence to support its claim. . .Instead, it must produce at least some "significant probative evidence tending to support the complaint."

T.W. Elec., 809 F.2d at 630 (citations omitted).

DISCUSSION

1. Jurisdiction

District courts have original jurisdiction of all civil proceedings arising under title 11, the bankruptcy laws. 28 U.S.C. § 1334 (Supp. 1992). The district courts may provide that "any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11" shall be referred to the district's bankruptcy judges. 28 U.S.C. § 157(a) (Supp. 1991). A bankruptcy court may enter appropriate orders and judgments regarding core bankruptcy proceedings. 28 U.S.C. § 157(b)(1). As to proceedings that are non-core but related to bankruptcy, the bankruptcy court submits proposed findings of fact and conclusions of law to the district court judge. 28 U.S.C. § 157(c)(1).

Plaintiffs allege that because their claims arise under state common law and not under bankruptcy law this court does not have jurisdiction. Alternatively, plaintiffs claims that "the most that can be said is that these claims are 'related to' cases under title 11 (the bankruptcy laws)." Because these were not core proceedings, plaintiffs argue, the bankruptcy judge had no authority to enter final judgment.

In granting defendants' motion to refer this action to the bankruptcy court, Judge Frye held that this action was a core proceeding. Such proceedings include, but are not limited to, matters concering the administration of the bankrupt estate and other proceedings affecting the liquidation of the estate assets. 28 U.S.C. § 157(b)(2). In concluding that this action was a core proceeding, Judge Frye reasoned that although this is a tort action, it involves a sale made by John Mitchell, Inc., the bankruptcy trustee, as part of the administration of the bankruptcy estate, and resolution of the matter will directly affect the liquidation of the bankruptcy estate's assets.

Defendants argue the Judge Frye's decision to refer is binding as "law of the case." That doctrine, however, is not a limit on courts' power; rather, it only expresses the general practive of courts not to reopen what has already be decided. *Christianson v. Colt Industries Operating Corp.*, 108 S.Ct. 2166, 2178 (1988).

Regardless of the nature of the previous decision to refer, I find it the correct decision. In general, claims against the debtor in possession (or the trustee, as in this case) arising from conduct connected with the estate after the bankruptcy petition is filed concern the administration of the estate and qualify as core matters. *In re Cinematronics, Inc.*, 916 F.2d 1444, 1450 (9th Cir. 1990). This holds true even when the claims involved are based on state law if the action seeks to impose personal liability on a trustee. *In re Jacksen*, 105 Bankr. 542, 544 (Bankr. 9th Cir. 1989).

PLAINTIFFS' CLAIMS

2. The fraud claim.

Plaintiffs, the HOPI shareholders, say that they formed and funded HOPI for the sole purpose of buying the assets of Harris Pine's furniture division. Plaintiffs claim that the purchase was made in reliance upon representations made by defendants Mitchell and Higgins, agents of defendant JMI.

Plaintiffs assert that during purchase negotiations defendants made representations and presented information showing that HPM was "only" losing relatively small amounts of money. Plaintiffs say they purchased the business in reliance on these representations and on their ability to make the company profitable by changing its management. They further allege that defendants did not disclose "huge" operatings losses that took place under defendants' management until after the sale closed, and that they never would have proceeded with the sale if they had known the true state of affairs. Finally, plaintiffs allege that there was substantial evidence from which a jury could find that defendants fraudulently concealed Harris Pine's unprofitability to dispose of HPM's assets.

Plaintiffs group defendants' allegedly fraudulent misrepresentations into four categories:

1. Defendants' accounting system. Plaintiffs say that defendants represented that the Harris Pine books were prepared on an accrual basis. They further state that under generally accepted accounting practices merchandise received but not paid for would be charged to accounts payable in an accrual basis system. Plaintiffs say that through discovery they have learned that payables were actually maintained on a cash basis. They allege that this practice enabled defendants to defer reporting steadily increasing amounts of payables, thereby substantially understating the unprofitability of Harris Pine prior to the sale.

2. The Rule 2015 reports. Plaintiffs allege that these reports, filed with the court and delivered to plaintiffs, consistently represented that accounts payable were current within 30 days; plus, defendants attached a schedule purportedly identifying the accounts payable due and owning on the date of the report. Plaintiffs further allege that defendants claim that they represented statements of accounts owed on the date of preparation of the reports, rather than the closing date of the reports. Plaintiffs allege that regardless of the time periods actually covered by these reports, plaintiffs have shown that there were hundreds of thousands of dollars of payables which were not recorded on the books of Harris Pine and not reported to the court in the Rule 2015 reports.

3. The gross margin issue. Plaintiffs allege that defendants represented to plaintiffs that Harris Pine had a 20 percent gross margin (the ratio of gross profit to sales), meaning that financial statements prepared in months in which a physical inventory was taken reduced inventory at the rate of 80 percent of total sales in order to derive profit or loss. Plaintiffs further allege that defendants represented that this gross margin figure had been verified by physical inventories. Plaintiffs allege that the gross margin was actually about 5 percent.

4. The check-holding allegation. Plaintiffs allege that throughout the latter part of 1988 Mitchell and Higgins

continued to represent that there were no material changes in the manner that HPM was doing business. Plaintiffs further allege that during this time the two defendants were failing to report increasingly large amounts of accounts payable and were holding increasingly large amounts of checks which had been written, but not released. Plaintiffs accuse defendants of holding $700,000 in checks and failing to report in excess of $400,000 of accounts payable by the end of 1988.

Plaintiffs say that they have demonstrated that defendants Mitchell and Higgins engaged in a pattern of misrepresentation to conceal the overwhelming unprofitability of Harris Pine. They allege that although Mitchell, as trustee, may have improved operations at the furniture operation he still lost millions and subsidized these losses by liquidating Harris Pine's timber holdings. Plaintiffs further allege that Mitchell wanted to sell the company to justify the "enormous" fee he charged, [3] and that no one shown the true state of the company would have bought it as a going concern.

I agree with Judge Perris that plaintiffs have standing to bring individual claims. I now turn to defendants' response to plaintiffs' allegations:[4]

Defendants' accounting system and the Rule 2015 reports. Plaintiffs allege that defendants' accounting system allowed them to defer steadily increasing amounts of payables, which resulted in an understatement of Harris Pine's unprofitability. Defendants argue that plaintiffs have produced

---

[3] At oral arguments the parties appeared to agree that this fee was in the range of $1 million.

[4] This response is to what defendants call plaintiffs' "new theory." Defendants allege that plaintiffs realized the "inherent impossibility" of their "old theory" after receiving defendants' motion for summary judgment, and that they abandoned their original claim. Defendants argue that a party cannot create a genuine issue of material fact for purposes of opposing a summary judgment motion by contradicting its own sworn statements. For purposes of this hearing, however, I need not consider that argument, as I am charged with considering the amended complaint and motions before me on appeal.

no evidence -- such as checks or invoices -- of unpaid accounts payable.

Defendants acknowledge that the 2015 reports did not include as expenses the amount of all payables existing at the end of the month. Instead, those amounts were included as expenses in the month in which they were paid, a practice Harris Pine followed both before and after bankruptcy.

Defendants say when the trustee took over operation of Harris Pine, he continued to use the company's existing accounting personnel and procedures and in fact got a court order to that effect. They further allege that the effect of Harris Pine's continued use of its system was at most that "unreported" expenses were recorded in the month after they were incurred, and that the amount of unreported payables did not increase.

Finally, defendants explain that the reason plaintiffs can produce no invoices which were not paid within 30 days is because Harris Pine paid vendors within that time period to take advantage of trade discounts.

The check-holding allegations. Defendants contend that lacking evidence that accounts payable were increasing, plaintiffs now infer that defendants "held" checks in order to conceal unpaid accounts.

Rochelle Griffin, who handled accounts payable at Harris Pine, said in her affidavit that because the company was in bankruptcy, some vendors required cash on delivery; thus, signed checks needed to be ready for those companies demanding COD. Higgins and Mitchell were the only people authorized to sign checks, and they were not in Pendleton every day. As a result, sometimes checks were prepared ahead and signed in anticipation of deliveries, and then held until the delivery was made.

Defendants say checks for non-COD items were also typically prepared ahead, as Higgins and Mitchell would sign a number of checks at one sitting a few times each month.

Defendant refers to the Christmas bonus checks as one example. On about December 7, 1988, defendants signed approximately 600 bonus checks for Harris Pine employees. They were held until the last pay day before Christmas. Such activity does not rise to an intentional holding of checks to hide payables, defendants claim.

The gross margin issue. Defendants maintain that the only other evidence plaintiffs have to support their allegations that the furniture division had a 5 percent gross margin were schedules prepared by Maitland, which defendants claim are based on inaccurate figures and incorrect assumptions.

First of all, defendants assert that the trustee used a formula whereby the cost of goods sold each month for the furniture division equals 80 percent of furniture division sales. Because the inventory usage component of cost of goods sold is essentially a fill-in number based on the 80 percent assumption, defendants claim it is arithmetically impossible for the furniture division's gross margin to be anything other that 20 percent in a month when no physical inventory is taken. However, in Schedule 1 prepared by Maitland, the furniture division's gross margin in August, 1988 is 4.6 percent.

Secondly, defendants say, the schedules assume that the inventory pricing difference between the 80 percent cost of goods sold formula used by the trustee and the 75 percent figure used for pricing inventory in the sale to HOPI amounts to only $160,000, whereas the actual difference is about $300,000.

Finally, defendants claim, Maitland's schedules assume that operating results in December, 1988 should have yielded a representative gross margin even though manufacturing ceased for two weeks at the end of the month, down time related to the need to take physical inventory in connection with the sale to HOPI. Maitland's schedules fail to make any allowance for this down time, defendants say.

Judge Glover found the following regarding the above allegations:

> And even if they weren't keeping accrual records there is no evidence on this record that they [defendants] were accumulating receivables -- or payables. Where's the evidence. They slop over another month. They're taking trade discounts. Where's the evidence in this record that they're, over some period of time, accumulating accounts payable.

I agree with Judge Glover that the evidence does not raise a genuine issue of material fact as to the existence of the alleged fraud.

At oral arguments, plaintiffs emphasized a graph they had prepared showing disproportionately high losses and expenditures in December, 1988. In their brief they claim that the "huge" amount of purchases recorded in December, January, February, and March can be attributed either to the payment of unrecorded payables incurred in the months before December or to the purchase of large quantities of inventory in December. "In either case it is evident plaintiffs were defrauded," they conclude.

As defendants point out, if defendants were accumulating hundreds of thousands of dollars in unpaid accounts payable each month, plaintiffs should be able to produce invoices and checks for at least one or two of those unpaid accounts. Plaintiffs conceded at oral arguments that they have not come up with any such evidence.

As to the large inventory purchase, defendants explain that the 2015 report for December, 1988 was prepared on a different computer than previous reports and many line items were classified differently in the December 1988 report. When considered as a whole, defendants say, no discrepancy exists. For example, while the reclassification of expenses resulted in figures showing that the cost of lumber and materials was

about $820,000 higher than the monthly average from June to November, 1988, it also caused other purchases to be $690,000 less than the monthly average.

Plaintiffs argue that these December figures -- extracted from the Maitland schedules -- are sufficient to merit submission of this case to a jury. I disagree. The party opposing a summary judgment motion must show that an inference from circumstantial evidence is reasonable in light of competing inferences. *Matsushita Elect. Indus. Co. v. Zenith Radio*, 475 U.S. 574, 588 (1986). In light of the lack of plaintiffs' evidence and the explanations offered by defendants in regard to their accounting records, no jury could find plaintiffs' inferences of fraud reasonable.

Defendants argue that they are also entitled to summary judgment because plaintiffs could not reasonably rely on any representation they made based on the following:

--Because of a disclaimer in the purchase and sale agreement, plaintiffs could not justifiably rely on the defendants' representations as a matter of law.

--Plaintiffs were aware that the 20 percent figure used to prepare the 2015 reports was only an estimate.

--Defendants told plaintiffs about inadequacies in Harris Pine's accounting system, especially as it relates to inventory.

--Plaintiffs undertook their own investigation of the furniture division's assets and operations and had unimpeded access to Harris Pine's records and employees. I find this argument particularly persuasive as two of the plaintiffs are CPAs -- while a third is a lawyer -- and were at no disadvantage when conducting their own investigation.

--Plaintiffs understood that the reported results for the period from June 1987 to June 1988 did not contain meaningful information about the operation of the furniture division. Thus, they could not have reasonably relied on any alleged representations about the gross margin or operating results based on their understanding of the November 1987 or June 1988 physical inventories.

--Plaintiffs must have observed that certain expenses were not being reported on an accrual basis, because they reviewed all of Harris Pine's 2015 reports and allegedly incorporated them into HOPI's business plan.

Although in general the issue of justifiable reliance should be decided by the trier of fact, in some circumstances courts have determined that there is insufficient evidence to support a reasonable inference by the factfinder in favor of the plaintiff. Judge Glover came to that conclusion in this case, and I believe it was correct. He found:

> So we have a trustee in bankruptcy operating a business who finds another purchaser, and then the plaintiff comes in and says, "Hey, I'm interested," and then we have an auction. And the plaintiff buys the assets at auction.
>
> Well, we're not quite done with negotiations, and there have been review of financial documents before and presumably -- I don't presume -- they're actually after this date of the auction. But we come up with an agreement that says in it the trustee is not representing anything concerning this business. In fact, one of the plaintiffs doesn't like that very well. But that's what the deal was, and it's in great big print.
>
> Now, we've got to be careful in enforcing those kinds of clauses in the law because one can't for instance, exculpate oneself from fraud through putting those kinds of things in agreements. So we don't throw it out altogether, but it's a statement that the trustee is making to these sophisticated purchasers two accountants and a lawyer, and they've had experience in this business that says, "Hey, you need to take a look at this thing. It's been in bankruptcy. And I've [the trustee] been operating it, and I'm not standing

> behind any representations. You bought it at aution. So be careful. It's more than that."
> It's saying, "Look, if you want to buy this thing, you really need to make your own decisions on it." That's really what the trustee's saying."

I conclude that the evidence in this case does not raise a genuine issue of material fact as to whether or not (1) defendants' alleged misrepresentations were material and (2) plaintiffs reasonably relied on them; additionally, a reasonable jury would not make such an inference. Thus, I need not not [sic] reach the other elements of a fraud claim. Judge Glover's decision granting defendants' motion for summary judgment on the fraud claim is affirmed.

3. The negligent misrepresentation claim.

Plaintiffs argue that defendants owed them a duty of care because they prepared financial statements and supplied them to plaintiffs. Defendants argue that plaintiffs failed to establish such a duty because, among other reasons, the transaction involved was at arm's length.

Plaintiffs assign as error what they characterize as Judge Glover's ruling that plaintiffs cannot bring a claim for negligent misrepresentation because they had a duty to investigate aspects of defendants' accounting system. Plaintiffs say that defendants never specifically alleged contributory negligence as an affirmative defense, and as such Judge Glover's ruling was wrong.

I need not reach this argument because I find as a matter of law that plaintiffs cannot maintain their claim for negligent misrepresentation. In a long-awaited ruling handed down only a month ago, the Oregon Supreme Court recognized the tort of 1negligent [sic] misrepresentation. *Onita Pacific Corp. v. Trustees of Bronson*, 315 Or. 149 (1992) (*Onita I*). While the court declined to state a black-letter rule regarding the tort's

scope of duty and recovery, *Onita*, 315 Or. at 159, it did make the following clarification: "In an arm's-length negotiation, a negligent misrepresentation is not actionable." *Onita*, 315 Or. at 165.

Regardless of the *Onita* opinion -- in the event that the retroactivity of this ruling becomes an issue -- I find that prior to its issuance, the law in Oregon was that in order to sustain a claim for negligent misrepresentation, the plaintiff must show "some relationship between the parties that gives rise to a duty other than that which exists simply by virtue of the foreseeability of harm." *Onita Pacific Corp. v. Trustees of Bronson*, 104 Or. App. 696, 708 (1990), *rev'd*, 315 Or. 149 (1992) (*Onita II*). Under both *Onita I* and *Onita II*, a negligent misrepresentation is not actionable if it occurred in an arm's-length transaction negotiated by adversarial parties.

The parties in this case were negotiating at arm's-length. Judge Glover's decision granting summary judgment for defendants' on the negligent misrepresentation claim is affirmed.

The ORICO claim.

The Oregon Racketeer Influenced and Corrupt Organization ("ORICO") statute allows plaintiffs to establish an ORICO claim by demonstrating that they were injured by a pattern of "racketeering activity," which includes committing crimes such as falsifying business records, issuing a false financial statement, obtaining an execution of documents by deception, perjury and mail fraud.

As explained above, I conclude plaintiffs have not established a reasonable inference of fraud. It follows that plaintiffs have not made a sufficient showing that defendents' alleged conduct constituted crimes and as such the bankruptcy court was correct in dismissing plaintiffs' ORICO claim. *Computer Concepts, Inc. v. Brandt*, 310 Or. 706, 717 (1990).

Plaintiffs claim that Judge Glover's *sua sponte* dismissal of the ORICO claims is reversible error because they were not given adequate notice to demonstrate genuine issues of material fact and present materials pertinent to the claims under consideration. While it's true that as a general rule a district court must give a losing party 10 days notice and a chance to present new evidence before granting summary judgment *sua sponte*, there's an important exception: the court may grant summary judgment if the losing party has had a full and fair opportunity to ventilate the issues involved in the motion. *United States v. Grayson*, 879 F.2d 620, 625 (9th Cir. 1989).

In light of the extensive briefing and oral arguments in this case, I find plaintiffs have had a fair and complete opportunity to present the issues involved in this case. I suspect Judge Glover's comments that the ORICO charge filed by plaintiffs is "improvident at best" is not a statement of personal opinion but rather a shorthand way of coming to the conclusion described above; at any rate, in view of the undisputed facts I find summary judgment on plaintiffs' ORICO claims appropriate.

DEFENDANT's COUNTERCLAIMS

5. Breach of contract (capitalization).

Defendants, in their first counterclaim, allege that plaintiffs Robblee and Maitland promised them that they would contribute $600,000 to the capitalization of HOPI in the form of $300,000 in cash and $300,000 in net worth of American Entertainment Centers, Inc. ("AEC"), the company Maitland owned.

Plaintiffs Robblee and Maitland counter that they had no enforceable contract with defendants; that capitalization of HOPI was a condition of financing of the transaction, not a contractual commitment; the condition was in fact met by

shareholders; and defendant has not been damaged by any alleged breach of contract.

Judge Glover concluded, "When one looks at the purchase and sale agreement in this particular case, which is the contract, it does not say anything about the capitalization of the new venture." I come to the same conclusion: The agreement contained no agreement by the shareholders regarding capitalization. In the absence of a contract, there can be no breach. Judge Glover's decision granting plaintiffs' motion for summary judgment on the breach of contract counterclaim is affirmed.

6. Breach of contract (stock option).

In their fourth counterclaim, defendants allege that plaintiffs Robblee and Maitland entered into an agreement with HOPI to purchase stock of HOPI in exchange for $600,000 in cash and assets. Defendants allege that defendant JMI, as a creditor of HOPI, is entitled to enfore the rights of HOPI to the performance of agreements with HOPI to purchase stock.

Plaintiffs argue that any claim that plaintiffs breached their agreements to subscribe for shares belongs to HOPI's bankruptcy trustee, and that defendant JMI may not enforce this claim. Defendants argue that this claim is personal to the Harris Pine trustee as a creditor of HOPI and may be pursued by it notwithstanding HOPI's bankruptcy. Defendants further argue that this is actually a claim sounding in tort whereby a creditor of a corporation may recover from shareholders who have received bonus or watered stock, although the claim is designated here as a breach of contract claim.

I find Judge Glover was correct in ruling that defendants have failed to create a reasonable inference of wrongdoing on plaintiffs' part. "The directors have the ability to value these kinds of things in whatever way they want to, and it seems to me that that isn't a separate and distince claim that's actionable,

and that particular counterclaim is dismissed." The ruling of the
bankruptcy judge is affirmed.

7. Conversion.

In their fifth counterclaim, defendants state that defendant JMI held a security interest in all of HOPI assets. They charge plaintiffs with improperly withdrawing HOPI assets and using them for plaintiffs' own benefits. They further allege that plaintiffs' actions deprived JMI of its right to possess the assets of HOPI and to have HOPI's obligations by JMI secured by those assets.

Defendants further claim that the withdrawal of the assets, in conjunction with Robblee's and Maitland's failure to contribute the promised capital, was a significant factor in HOPI's failure. Finally, defendants allege those actions were malicious and taken with wanton disreqard of JMI and other HOPI creditors.

Plaintiffs argue that this counterclaim must fail because Congress, not JMI, is the real party in interest; plaintiffs are not liable for any alleged conversion; and the payments do not constitute a converstion.

Plaintiffs note that under the Uniform Commercial Code, a secured creditor with the right to possession of collateral after default may maintain an action for conversion against one who has exercised unauthorized acts of dominion over the property to the exclusion of the creditor's right. However, I find no evidence here that JMI declared HOPI to be in default, and the payment to AEC (one of the assets used for plaintiffs' own benefit) was made before the disputes between HOPI and JMI arose. Accordingly, I conclude defendants have not made out a case of conversion.

Judge Glover's decision granting plaintiffs' motion for summary judgment on defendants' conversion counterclaim is affirmed.

6. Other counterclaims.

Defendants also appeal Judge Glover's dismissal of defendants' second and third counterclaims for promissory estoppel and quantum meruit, respectively. These two counterclaims were not briefed by the parties on appeal; however, based on the extensive record, I affirm Judge Glover's dismissal of these two counterclaims.

AWARD OF COSTS

Plaintiffs allege that Judge Glover erred in awarding costs to defendants, arguing that they incurred costs in defending against the counterclaims. However, those counterclaims appear to be more in the nature of the old maxim, "the best defense is a strong offense." Plaintiffs initially filed this action and judgment on those initial claims was for defendants. I find no abuse of discretion in Judge Glover's award of costs to defendants.

CONCLUSION

The decision of the bankruptcy judge granting defendants' motions for summary judgment on plaintiffs' claims and plaintiffs motions for summary judgment on defendants' counterclaims is AFFIRMED.

DATED this 12 day of March, 1993.

ROBERT E. JONES
United States District Judge

IN THE CIRCUIT COURT OF THE STATE OF OREGON
FOR THE COUNTY OF MULTNOMAH

GEORGE MAITLAND, NEIL ROBBLEE, and CARY GARMAN,	
Plaintiffs,	No. A9008-05180
v.	COMPLAINT
JOHN MITCHELL; JOHN MITCHELL, INC., an Oregon corporation; and RODGERS HIGGINS,	(Fraud; Negligent Misrepresentation; Negligence)
Defendants.	JURY TRIAL DEMANDED

ALLEGATIONS COMMON TO ALL CLAIMS

1.

Plaintiffs George Maitland ("Maitland") and Neil Robblee ("Robblee") are residents of the state of Washington. Plaintiff Cary Garman ("Garman") is a resident of the state of Oregon. Defendants John Mitchell ("Mitchell") and Rodgers Higgins are residents of the state of Oregon and defendant John Mitchell, Inc. ("JMI") is an Oregon corporation.

2.

At material times JMI was the duly appointed trustee of the bankruptcy estate of Harris Pine Mills, an Oregon corporation. Between approximately December 8, 1986 and December 31, 1988 defendant JMI managed the operations of Harris Pine Mills, including its furniture division. Defendant

Mitchell was the primary officer of JMI and was personally involved in the management of Harris Pine Mills and the reporting of operations thereof. Defendant Rodgers Higgins was the agent of JMI and was personally involved in the management of Harris Pine Mills and the reporting of operations thereof.

3.

At the time that JMI became trustee of Harris Pine Mills the furniture division had on stock a large quantity of unsaleable inventory. At the material times alleged herein defendants knew the nature and the extent of the unsaleable inventory.

4.

During the fall of 1988 defendant Mitchell negotiated with plaintiffs for the purchase and sale of the assets of the furniture division of Harris Pine Mills. At all material times defendant knew that plaintiffs intended to form a new corporation to purchase the assets. On October 3, 1988 defendants accepted plaintiffs' offer for the purchase of the assets.

5.

On December 9, 1988 plaintiffs formed Harris of Pendleton, Inc. ("HOPI"), and Oregon corporation, to purchase the assets. The corporation was capitalized with cash and other valuable assets. Plaintiff Robblee contributed cash or its equivalent in the amount of $350,000 in exchange for 51% of the HOPI stock. Plaintiff Garman contributed $50,000 in exchange for 5% of the HOPI stock. Plaintiff Maitland contributed his stock in American Entertainment Centers, Inc., and other valuable consideration, which had a reasonable value of $1,161,000, in exchange for 35% of the HOPI stock. Plaintiff Maitland subsequently acquired the remaining 8% of HOPI stock.

6.

The sale of the assets of the furniture division of Harris Pine Miles was closed effective December 31, 1988.

FIRST CLAIM
Fraud

7.

To induce plaintiffs to form a corporation to purchase the assets, defendants in the fall of 1988 supplied plaintiffs with monthly financial statements regarding the operations of Harris Pine Mills including the furniture division. Defendants represented that the financial statements were prepared on an accrual basis, except that they did not reflect depreciation. Defendant Mitchell represented that the financial statements were true, correct and accurate and fairly represented the financial condition of Harris Pine Mills.

8.

During the negotiations in the fall of 1988 defendant Mitchell also represented that under his management of the furniture division he had identified slow moving, obsolete or unmarketable inventory and that no value would be assigned to such inventory in the sale.

9.

The financial statements prepared by defendants and delivered to plaintiffs revealed that the furniture division showed a gross margin of approximately 25% and net losses of approximately $30,000 per month. The last financial statement prepared by defendants prior to the sale was for the month of November 1988 and showed a net profit. Plaintiffs reasonably relied upon the financial statements and representations by defendants. Plaintiffs had considerable expertise in the furniture business and knew that by consolidating the furniture division with American Entertainment Centers, Inc., a business owned by plaintiff Maitland, and by introducing management efficiencies the furniture division could be made profitable, assuming defendants' representations were true. Furthermore, plaintiffs Maitland and Garman are certified public accountants who

analyzed the financial statements in detail before consummating the purchase.

10.

In making such representations defendants Mitchell and Higgins were acting as agents for JMI.

11.

All representations and omissions were material to plaintiffs. In reliance upon defendants' representations plaintiffs formed Harris of Pendleton, Inc. and contributed capital, as alleged.

12.

The sale of the assets of the furniture division was closed effective December 31, 1988. After the closing defendants prepared financial statements regarding Harris Pine Mills for the month of December 1988 and reported a loss from the operation of the furniture division of approximately $1,200,000. The reporting of this loss reflects liabilities known to defendants to have been incurred prior to the date of sale, but not disclosed to plaintiffs.

13.

According to financial reports prepared by defendants for the months January 1989 through April 1989 additional losses were incurred by the furniture division of approximately $650,000. These losses represent additional liabilities incurred prior to the sale of the furniture division but not disclosed to plaintiffs.

14.

Prior to closing the sale defendants performed three physical inventories, one in November 1987, one in June 1988 and another in December 1988. Defendants represented to plaintiffs that when the physical inventories were performed and the values assigned defendants had excluded all inventory that was not in the current line of product marketed by the furniture division or that was known to be unsaleable. Defendants represented that the gross margin on sales was

25% and for that reason the inventory was valued at selling price less 25%.

15.

After the sale of the furniture division assets plaintiffs learned that the inventory purchased by HOPI included slow moving, obsolete and unsaleable items valued at no less that $1,374,000 on the inventory list. HOPI operated the furniture division between January 1, 1989 and February 1990. Plaintiffs then discovered that the gross margin on sales was considerably less than reported, and that the business was overwhelmingly unprofitable. Despite plaintiffs' best efforts the business failed. HOPI filed for bankruptcy in December 1989 and plaintiffs have lost their investments in HOPI.

16.

Defendants knew that their representations were false and they made the representations with the intent to deceive plaintiffs and induce them to form a corporation to purchase the furniture division. As a result of defendants' misrepresentations plaintiffs have been damaged in the amounts stated in paragraph 5, above.

17.

Defendants' conduct was aggravated and in violation of societal interests. Plaintiffs are each entitled to an award of punitive damages from defendants in the amount of $1,000,000.

SECOND CLAIM
(Negligent Misrepresentation)

18.

Plaintiffs reallege paragraphs 7 through 15.

19.

In the course of their business and a business transaction in which they had a pecuniary interest defendants supplied false information to plaintiffs to guide them in their decision whether to purchase the assets of the furniture division.

Defendants failed to exercise reasonable care or competence in obtaining or communicating the information.

20.

Defendants supplied the information to plaintiffs for their benefit and guidance. Defendants intended plaintiffs to rely upon the information and knew that plaintiffs would reasonably rely thereon.

21.

The information supplied by defendants to plaintiffs was false. Plaintiffs justifiably relied upon it to their detriment. As a result, plaintiffs have lost their investment in HOPI and have been damaged in the amounts stated in paragraph 5, above.

THIRD CLAIM
(Negligence)

22.

Plaintiffs reallege paragraphs 1 through 21.

23.

Defendants were negligent in one or more of the following particulars:

A) In failing to determine whether financial reports supplied to plaintiffs were accurate depictions of the financial status of Harris Pine Mills;

B) In failing to determine whether obsolete or unmarketable parts and inventory were included in the sale of the furniture division;

C) In failing to determine the true gross margin on sales before making representations to plaintiffs;

D) In failing to determine and report on financial statements all the liabilities of Harris Pine Mills prior to the sale of the furniture division.

24.

There was a foreseeable risk that defendants' negligence would cause harm to plaintiffs. Plaintiffs had an interest to be protected and relied on defendants for true and accurant

representation of the financial condition of the furniture division. Defendants knew that plaintiffs were relying on their representations. Plaintiffs had a right to truthful information from defendants.

25.

As a result of defendants' negligence plaintiffs have been damaged by the loss of their investments in HOPI, in the amounts stated in paragraph 5.

WHEREFORE, plaintiff Maitland prays for judgment against defendants, jointly and severally, as follows:

on the First Claim for $1,161,000, plus punitive damages of $1,000,000;

on the Second Claim for $1,161,000; and

on the Third Claim for $1,161,000.

Plaintiff Robblee prays for judgment against defendants, jointly and severally, as follows:

on the First Claim for $350,000, plus punitive damages of $1,000,000;

on the Second Claim for $350,000; and

on the Third Claim for $350,000.

Plaintiff Garman prays for judgment against defendants, jointly and severally, as follows:

on the First Claim for $50,000, plus punitive damages of $1,000,000;

on the Second Claim for $50,000; and

on the Third Claim for $50,000;

plus their costs and disbursements incurred herein.

BENNETT & DURHAM

_____

Michael J. Morris, OSB #77283
Of Attorneys for Plaintiffs

STATUTORY PROVISIONS INVOLVED

1. 28 U.S.C. 157 provides:

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

(2) Core proceedings include, but are not limited to--

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

(C) counterclaims by the estate against persons filing claims against the estate;

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modity the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; and

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder realtionship, except personal injury tort or wrongful death claims.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).

(5) The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

(c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own

motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

2. 28 U.S.C. 1334 provides:

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other that the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

(d) Any decision to abstain or not to abstain made under this subsection (other than a decision not to abstain in a proceeding described in subsection (c)(2)) is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. This

subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.